In the Supreme Court of the United States

October Term, 1972

No. 72-90

United States of America, petitioner,

v.

Chicago, Burlington & Quincy Railroad Company

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

INDEX

	Page
Docket entries in the United States Court of Claims	1
Petition	21
Answer	31
Joint Exhibit 5	35
Donations Excluded from Roadway Depreciation Base	
Defendant's Exhibit 3-DP	
Letter, Acting Commissioner of Internal Revenue to Chicago, Burlington & Quincy Railroad Company, dated September 20, 1944	52
Defendant's Exhibit 4-DP	
Letter, Chicago, Burlington & Quincy Railroad Company to Commissioner of Internal Revenue, dated April 20, 1945	55
Defendant's Exhibit 5-DP	
Letter, Deputy Commissioner of Internal Revenue to Chicago, Burlington & Quincy Railroad Company, dated April 12, 1943	56
Defendant's Exhibit 6-DP	
Mimeo 58, enclosure to letter of April 12, 1943	57

Page

Defendant's Exhibit 7-DP
Letter, Chicago, Burlington & Quincy Railroad Company to District Director, dated December 14, 1959 67
Defendant's Exhibit 8-DP
Letter, Internal Revenue Service to Chicago, Burlington & Quincy Railroad Company, dated July 26, 1961 68
Testimony of Merrill D. Knight, from transcript of trial session at Washington, D.C., March 11, 1969, pp. 70-101 71
Excerpts from testimony of John W. Wheeler, from transcript of trial session at Chicago, Illinois, January 15, 1968, pp. 13, 20-22, 34-68, 84-88, 94-95 89
Order of the Supreme Court of the United States granting a Writ of Certiorari (filed October 24, 1972) 113

UNITED STATES COURT OF CLAIMS

DOCKET ENTRIES

GENERAL DOCKET CASE NO. 149-65

Title of Case	Attorneys
CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY vs. THE UNITED STATES Income tax.	FOR PLF.: Atty of Record Eldon Martin, Richard T. Cubbage, Gerald J. O'Rourke, Jr., Robert E. Simpson of counsel FOR U.S. Frances Foltz Kane Robert T. Molloy Rosslyn Building, North 1911 North Fort Myer Drive Arlington, Virginia 22209 Atty of Record.
May 7, 1965 PETITION FILED. 10 COPIES OF PETITION TO DEFENDANT. AMOUNT CLAIMED: $492,290.25 +$3,105.77 PLAINTIFF'S ADDRESS: 547 West Jackson Blvd., Chicago.	

Date	Proceedings
May 7, 1965	Filing fee of $10 paid by plaintiff.
June 7, 1965	Court filed order referring case to Commr. vacated 12-5-67.
Jul. 6, 1965	Defendant's motion for extension of time (to September 4, 1965) to file answer filed. Copies (2) to atty. ALLOWED Jul. 19, 1965
Sep. 7, 1965	Defendant's answer to plaintiff's petition filed. Copies (2) to atty. (and affirmative defense)
Sep. 13, 1965	Plaintiff's reply to defendant's answer filed. Copies (10) to deft.
Sep. 13, 1965	Printed copies of defendant's answer received. Copies (10) to atty.
Sep. 22, 1965	Plaintiff's motion to dismiss defendant's setoff defense, or in the alternative, to direct deft. to demonstrate a reasonable basis therefor, filed. Copies (2) to deft. ALLOWED OCT. 5, 1965, to the extent that defendant is to demonstrate within 30 days that it has concrete and positive evidence that there is a reasonable basis for the setoff defense.
Oct. 27, 1965	See 164-65 for defendant's motion for production. See entry Nov. 10, 1965.
Oct. 27, 1965	See 164-65 for defendant's motion for call. See entry Nov. 10, 1965.
Oct. 28, 1965	Defendant's motion for extension of time (to February 2, 1966) to demonstrate reasonable basis for set off defense filed. Copies (2) to atty. (in this and 164-65) ALLOWED NOV. 10, 1965 with no further extension to be granted.
Nov. 3, 1965	Plaintiff's objection to defendant's motion for extension of time to demonstrate reasonable basis, etc. filed. Copies (2) to deft.

Date	Proceedings
Nov. 3, 1965	See 164-65 for—Plaintiff's objection to motions for production & Call.
Nov. 10, 1965	Re defendant's motion for production pursuant to Rule 40, ALLOWED WITH THE DOCUMENTS TO BE PRODUCED AT THE OFFICE OF THE ATTORNEY FOR THE PLAINTIFF FOR INSPECTION AND COPYING BY DEFENDANT NOT LATER THAN 30 DAYS FROM THE DATE OF ISSUANCE OF THIS ORDER. in this and 164-65.
Nov. 10, 1965	Re defendant's motion for call pursuant to Rule 39, ALLOWED WITH COMPLIANCE NOT LATER THAN 30 DAYS FROM THE ISSUANCE OF THIS ORDER. in this and 164-65.
Nov. 16, 1965	Plaintiff's partial objection to order allowing defendant's motion to produce and request to amend said order filed. Copies (2) to deft. (in this and 164-65) The order of November 10, 1965, allowing production of documents is vacated and deft's. motion is DENIED without prejudice.
Nov. 16, 1965	Plaintiff's reply to defendant's motion for call filed. Copies (2) NOV. 29, 1965. to deft. (in this and 164-65). (Compliance to motion).
Nov. 26, 1965	Defendant's response to plaintiff's partial objection to order allowing defendant's motion to produce and request to amend said order filed. Copies (2) to atty. (in this and 164-65).
Jan. 10, 1966	Defendant's motion for leave to serve upon plaintiff a request for admissions filed. Copies (2) to atty. SEE ENTRY OF JAN. 18, 1966.
Jan. 17, 1966	Plaintiff's objection to defts. motion for admissions filed. Copies (2) to deft.

Date	Proceedings
Jan. 18, 1966	Re Defendant's motion of January 10, 1966: ALLOWED with plaintiff to have 30 days to respond. Defendant is allowed a further extension to reply to the order of October 5, 1965 until 15 days after filing of plaintiff's response.
Feb. 11, 1966	Plaintiff's answers to defendant's request for admissions received. Copies (2) to deft.
Feb. 28, 1966	Defendant's submission purs. to Commrs. Order of Oct. 5, 1966 filed. Copies (2) to atty.
Apr. 5, 1966	Commissioner's order under Rule 43 filed. Copy to parties.
Apr. 26, 1966	Plaintiff's motion for extension of time (to June 4, 1966) to respond to order of commissioner under rule 43 filed. Copies (2) to deft. (in this and 164-65) ALLOWED MAY 9, 1966.
Jun. 2, 1966	Plaintiff's response to pretrial order of April 5, 1966, Rec. Copies (2) to deft.
Jun. 29, 1966	Defendant's motion for extension of time (to Sept. 4, 1966 to) file response pursuant to order of commissioner under Rule 43 filed. Copies (2) to atty. ALLOWED JULY 13, 1966.
Sep. 6, 1966	Defendant's motion for extension of time (to Oct. 4, 1966 to) file response pursuant to order of commissioner under Rule 43 filed. Copies (2) to atty. ALLOWED SEPT. 19, 1966.
Oct. 4, 1966	Defendant's motion for extension of time (to Oct. 18, 1966 to) file response pursuant to order of commissioner under Rule 43 filed. Copies (2) to atty. ALLOWED OCT. 5, 1966.

Date	Proceedings
Oct. 18, 1966	Defendant's motion for extension of time (to Nov. 17, 1966) to file response purs. to order of Commissioner under Rule 43, filed. Copies (2) to atty. ALLOWED OCT. 19, 1966.
Nov. 17, 1966	Defendant's motion for extension of time (to November 21, 1966) to file response to Rule 43 order filed. Copies (2) to atty. ALLOWED NOV. 18, 1966.
Nov. 21, 1966	Defendant's response pursuant to commissioner's pretrial order under Rule 43 received. Copies (2) to atty.
Sep. 20, 1967	Commissioner's memorandum on pretrial conference filed. Copy to parties.
Sep. 20, 1967	Defendant's motion for extension of time (to September 22, 1967) to file its amended answer filed. Copies (2) to atty. ALLOWED SEP. 22, 1967.
Sep. 22, 1967	Defendant's supplemental motion to correct motion for time extension filed. Copy to parties. ALLOWED SEP. 22, 1967.
Sep. 22, 1967	Defendant's motion for leave to file a first amended answer filed. Copies (2) to atty. See Order of Oct. 24, 1967.
Oct. 2, 1967	Plaintiff's motion for extension of time (to October 7, 1967) to file objections to motion for leave to file first amended answer filed. Copies (2) to deft. (in this and 164-65) ALLOWED OCT. 3, 1967, as to case no. 149-65.
Oct. 9, 1967	Plaintiff's objection to defendant's motion for leave to file a first amended answer filed. Copies (2) to deft.
Oct. 11, 1967	Plaintiff's submission identifying prospective witnesses pursuant to requirement

Date	Proceedings
	of pretrial memorandum of September 20, 1967 received. Copies (2) to deft.
Oct. 19, 1967	Defendant's response to plaintiff's objection to defendant's motion for leave to file a first amended answer filed. Copies (2) to atty.
Oct. 24, 1967	Commr's order allowing Deft's motion for leave to file first amended answer filed. Copies to parties.
Oct. 24, 1967	Deft's first amended answer filed. Copies (2) to atty.
Nov. 13, 1967	Defendant's motion for extension of time (to November 16, 1967) to comply with commissioner's order of October 24, 1967 filed. Copies (2) to atty. ALLOWED NOV. 14, 1967.
Nov. 14, 1967	Defendant's first amended answer filed. Copies (10) to atty. (ie, printed copies of first amended answer rec'd). (Filed Oct. 24, 1967).
Nov. 16, 1967	Defendant's motion for extension of time (to December 17, 1967) to comply with commissioner's order filed. Copies (2) to atty. ALLOWED TO DEC. 1, 1967, NOV. 21, 1967, see entry.
Nov. 17, 1967	Plaintiff's reply to first amended answer filed by leave of commissioner (oral allowance). Copies (10) to deft.
Nov. 20, 1967	Defendant's submission pursuant to the commissioner's order of October 24, 1967 filed. Copies (2) to atty.
Nov. 20, 1967	Plaintiff's objection to defendant's motion for extension of time filed. Copies (2) to deft.
Nov. 20, 1967	Stipulation of facts filed by plaintiff. Copies (2) to deft.

Date	Proceedings
Nov. 21, 1967	Re defendant's motion of Nov. 16, 1967: Defendant is allowed an extension to and including December 1, 1967, to comply with paragraph 2 of the order of October 24, 1967, with no further extension to be allowed for any reason.
Nov. 27, 1967	Defendant's motion for an order requiring plaintiff to respond to defendant's request for admissions on or before December 15, 1967 filed. Copies (2) to atty. ALLOWED DEC. 8, 1967.
Nov. 27, 1967	Defendant's motion for leave to file a request for admissions filed. Copies (2) to atty. ALLOWED DEC. 8, 1967. Plaintiff to respond on or before December 15, 1967.
Nov. 29, 1967	Plaintiff's motion for extension of time (to December 10, 1967) to respond to defendant's submission filed. Copies (2) to deft. ALLOWED DEC. 1, 1967.
Nov. 30, 1967	Plaintiff's objection to defendant's motion for leave to file a request for admission filed. Copies (2) to deft.
Dec. 1, 1967	Defendant's submission pursuant to the commissioner's order of October 24, 1967 filed. Copies (2) to atty.
Dec. 5, 1967	Court filed order referring case to Commissioner James F. Davis.
Dec. 11, 1967	Plaintiff's responses to defendant's submissions pursuant to the commissioner's order of October 24, 1967 filed. Copies (2) to deft.
Dec. 14, 1967	Plaintiff's answers to defendant's request for admissions with respect to the Section 1341 issue received. Copies (2) to deft.
Dec. 21, 1967	Commissioner's memorandum of pretrial conference filed. Copy to parties. (defend-

Date	Proceedings
	ant to file document by Dec. 29, 1967, pltf's. due: Jan. 5, 1968 and defendant granted leave to take deposition of John W. Wheeler).
Dec. 22, 1967	Plaintiff's supplement to submission identifying prospective witnesses pursuant to pretrial memorandum filed. Copies (2) to deft.
Dec. 29, 1967	Defendant's supplemental submission pursuant to the Commissioner's order of October 24, 1967, relating to the vacation pay accrual issue filed. Copies (2) to atty.
Jan. 5, 1968	Plaintiff's response to defendant's submission pursuant to the commissioner's order of October 24, 1967 relating to the vacation pay accrual issue filed. Copies (2) to deft.
Jan. 9, 1968	Plaintiff's motion for issuance of subpoena (on Anthony S. Filicicchia) filed. Copies (2) to deft. ALLOWED JAN. 10, 1968.
Jan. 10, 1968	Commissioner's order and memorandum re burden of proof filed. Copies (2) to parties.
Jan. 12, 1968	Deposition of Merrill D. Knight filed. Notice to parties.
Jan. 12, 1968	Depositions of Douglas A. Rieser and Anthony S. Filicicchia together with 3 exhibits attached filed. Notice to parties.
Jan. 17, 1968	Plaintiff's motion for extension of time (to February 16, 1968) to file a request for review of the commissioner's order and memorandum re burden of proof filed. Copies (2) to deft. ALLOWED JAN. 31, 1968.
Jan. 22, 1968	Certificate of reporting arrangements filed by plaintiff.

Date	Proceedings
Jan. 22, 1968	Certificate of reporting arrangements filed by defendant.
Feb. 5, 1968	Plaintiff's exhibit 183 filed. Notice to parties.
Feb. 14, 1968	Transcript of testimony (4 vol's.) taken at Chicago, Illinois on January 15, 16, 17 & 18, 1968, together with plaintiff's exhibits 1 thru 182, 184 thru 206, defendant's exhibits 1 thru 37 and the AFE's listed on page 883 of transcript as being introduced in evidence by stipulation filed. Notice to parties.
Feb. 16, 1968	Plaintiff's request for review of commissioner's order and memorandum re burden of proof filed. Copies (2) to deft.
Mar. 4, 1968	Defendant's motion for leave to respond to plaintiff's request for review of commissioner's order, and request for extension of time (to March 14, 1968) to so respond. ALLOWED MAR. 8, 1968.
Mar. 14, 1968	Defendant's motion to strike paragraphs 36-39 of its first amended answer filed. Copies (2) to atty. ALLOWED MAR. 28, 1968.
Mar. 14, 1968	Defendant's memorandum of law in response to plaintiff's request for review of commissioner's order, etc. filed. Copies (2) to atty.
Mar. 25, 1968	Plaintiff's motion to file reply to Government's memorandum of law re burden of proof filed. Copies (2) to deft. ALLOWED MAR. 26, 1968.
Mar. 26, 1968	Plaintiff's reply to government's memorandum of law re burden of proof filed. Copies (2) to deft.

Date	Proceedings
Apr. 5, 1968	Court entered order denying plaintiff's request for review filed February 16, 1968. Copy to parties.
Jul. 3, 1968	Plaintiff's motion for leave to take discovery deposition (of J. H. Scholl) filed. Copies (2) to deft. DENIED SEP. 6, 1968.
Jul. 12, 1968	Defendant's response to plaintiff's motion for leave to take discovery deposition filed. Copies (2) to atty.
Jul. 17, 1968	Plaintiff's motion for leave to file reply to defendant's response to plaintiff's motion for leave to take discovery deposition filed. Copies (2) to deft. ALLOWED SEP. 16, 1968, as of Sep. 6, 1968. and filed this day.
Jul. 18, 1968	Plaintiff's motion for leave to file first amended petition filed. Copies (2) to deft.
Jul. 24, 1968	Commissioner's memorandum of informal conference filed. Copy to parties.
Jul. 24, 1968	Plaintiff's first amended petition filed. Copies (10) to deft.
Sep. 13, 1968	Plaintiff's appeal from order of trial commissioner of Sept. 6, 1968, denying plaintiff's motion for leave to take discovery deposition of J. H. Scholl filed. Copies (2) to deft. DENIED OCT. 18, 1968.
Sep. 16, 1968	Plaintiff's reply to defendant's response to taxpayer's motion for leave to take discovery deposition filed. Copies (2) to deft.
Sep. 18, 1968	Defendant's motion for extension of time (to October 9, 1968) to answer amended petition filed. Copies (2) to atty. ALLOWED OCT. 1, 1968.
Sep. 19, 1968	Commissioner's memorandum regarding plaintiff's request for review of commissioner's order, filed September 13, 1968, filed. Copy to parties.

Date	Proceedings
Oct. 4, 1968	Defendant's answer to first amended petition filed. Copies (2) to atty.
Oct. 11, 1968	Printed copies of defendant's answer to first amended petition received. Copies (9) to atty.
Oct. 18, 1968	Plaintiff's motion for call and for production of documents filed. Copies (2) to deft. DENIED NOV. 20, 1968. *Shakespeare Co., v. United States* 389 F. 2d 772 (Ct Cls. 1968).
Oct. 23, 1968	Defendant's motions for admissions pursuant to Rule 42 and for pretrial order pursuant to Rule 43 filed. Copies (2) to atty. ALLOWED NOV. 6, 1968.
Oct. 28, 1968	Defendant's motion for extension of time (to November 15, 1968) to respond to motion for call, etc. filed. Copies (2) to atty. ALLOWED NOV. 13, 1968.
Nov. 1, 1968	Defendant's motion for leave to file a second amended answer filed. Copies (2) to atty. ALLOWED NOV. 15, 1968.
Nov. 15, 1968	Defendant's second amended answer filed. Copies (10) to atty.
Nov. 15, 1968	Defendant's response to plaintiff's motion for call, etc. filed. Copies (2) to atty.
Nov. 19, 1968	Defendant's motion for order permitting introduction of additional documents and facts regarding the donated property issue filed. Copies (2) to atty. ALLOWED DEC. 4, 1968. See letter to the parties this date.
Nov. 22, 1968	Plaintiff's response and objection to motion for order permitting introduction of additional documents, etc. filed. Copies (2) to deft.

Date	Proceedings
Nov. 27, 1968	Plaintiff's request for review of order of trial commissioner of November 20, 1968, denying plaintiff's motion for call and for production of documents filed. Copies (2) to deft.
Nov. 27, 1968	Plaintiff's request for oral argument on plaintiff's request for review, etc. filed. Copies (2) to deft.
Dec. 11, 1968	Plaintiff's request for review of trial commissioner's order allowing defendant's motion to reopen the record with respect to the donated property issued filed. Copies (2) to deft.
Dec. 12, 1968	Plaintiff's motion for admissions pursuant to Rule 42 filed. Copies (2) to deft. ALLOWED DEC. 26, 1968.
Jan. 14, 1969	Defendant's response to plaintiff's request for admissions received. Copies (2) to atty.
Jan. 31, 1969	Court entered order granting plaintiff's request for oral argument, placing plaintiff's request for review of order of trial commissioner of November 20, 1968, denying plaintiff's motion for call and for production of documents, on an appropriate calendar for oral argument, and denying plaintiff's request for review of trial commissioner's order allowing defendant's motion to reopen the record with respect to the donated property issue. Copy to parties.
Feb. 4, 1969	Plaintiff's motion for admissions pursuant to Rule 42 filed. Copies (2) to deft. ALLOWED FEB. 17, 1969.
Feb. 5, 1969	Plaintiff's motion [for leave to serve a request for] admissions pursuant to Rule 42 filed. Copies (2) to deft. ALLOWED FEB. 25, 1969.

Date	Proceedings
Feb. 7, 1969	Defendant's motion for leave to file a third amended answer filed. Copies (2) to atty. (See Commr's order April 7, 1969).
Feb. 13, 1969	Plaintiff's motion for extension of time (to March 17, 1969) to respond to motion for leave to file a third amended answer filed. Copies (2) to deft. ALLOWED FEB. 28, 1969, without prejudicing defendant's rights to further trial preparation in the event the third amended answer is filed.
Feb. 14, 1969	Plaintiff's motion for leave to serve a request for admissions with respect to the second hand rail issue filed. Copies (2) to deft. ALLOWED FEB. 28, 1969.
Feb. 18, 1969	Plaintiff's motion for pretrial order filed. Copies (2) to deft. ALLOWED FEB. 28, 1969, to the extent that defendant submit a list of prospective witnesses insofar as it has not already done so.
Feb. 18, 1969	Defendants opposition to plaintiff's motion for enlargement of time, or, in the alternative, defendant's request for a protective order filed. Copies (2) to atty.
Feb. 20, 1969	Defendant's response to motion for pretrial order filed. Copies (2) to atty.
Feb. 27, 1969	Plaintiff's motion for leave to take discovery deposition of Arthur H. Gass filed. Copies (2) to deft. ALLOWED MAR. 12, 1969.
Mar. 3, 1969	Argued and submitted on plaintiff's request for review of Commissioner's order denying plaintiff's motion for call and production. Deft to file memo relative to possible stipulation.
Mar. 6, 1969	Defendant's motion for extension of time (to March 21, 1969) to respond to request for admissions, etc. filed. Copies (2) to

Date	Proceedings
	atty. ALLOWED MAR. 10, 1969, to the extent that defendant's to respond be MAR. 14, 1969.
Mar. 7, 1969	Plaintiff's objection to defendant's motion for extension of time filed. Copies (2) to deft.
Mar. 7, 1969	Defendant's response to plaintiff's two requests for admissions with respect to the secondhand rail issue received. Copies (2) to atty.
Mar. 14, 1969	Defendant's memorandum to the court filed. Copies (2) to atty.
Mar. 14, 1969	Plaintiff's motion for extension of time (to April 1, 1969) to respond to motion for leave to file a third amended answer filed. Copies (2) to deft. ALLOWED MAR. 27, 1969.
Mar. 14, 1969	Defendant's motion for extension of time (to March 19, 1969) to respond to request for admissions filed. Copies (2) to atty. ALLOWED MAR. 20, 1969.
Mar. 17, 1969	Pltf's objection to Deft's motion for time extension filed. Copies (2) to deft.
Mar. 17, 1969	Pltf's response to Deft's memorandum to the Court & Pltf's motion to strike argumentative provisions of stipulation, etc. filed. Copy to deft.
Mar. 19, 1969	Defendant's response to plaintiff's request for admissions concerning the Mexican Tax Credit Issue received. Copies (2) to atty.
Mar. 28, 1969	Plaintiff's objection to the motion for leave to file a third amended answer filed. Copies (2) to deft.

Date	Proceedings
Apr. 7, 1969	Commissioner's order denying defendant's motion for leave to file a third amended answer filed. Copy to parties.
Apr. 8, 1969	Defendant's response to plaintiff's motion to strike (filed March 17) filed. Copies (2) to atty.
Apr. 10, 1969	Transcript of testimony (1 volume) taken at Washington, D. C. on March 11, 1969, together with plaintiff's exhibits 1-MT thru 8-MT and defendant's exhibits 1-MT thru 4-MT, 6-MT thru 17-MT, 1-DP and 2-DP filed. Notice to parties.
Apr. 10, 1969	Deposition of Arthur H. Gass filed. Notice to parties.
Apr. 24, 1969	Defendant's motion to dismiss plaintiff's request for review (filed November 27, 1968) as moot filed. Copies (2) to atty. SEE COURT ORDER OF MAY 2, 1969.
Apr. 25, 1969	Plaintiff's motion for withdrawal of request for review of trial Commissioner's order of Nov. 20, 1968 filed. Copies (2) to deft. SEE COURT ORDER OF MAY 2, 1969.
Apr. 29, 1969	Transcript of testimony (three volumes) taken at Chicago, Illinois on March 25, 26 and 27, 1969, together with plaintiff's exhibits 9-MT thru 20-MT, 1-SR thru 14-SR and defendant's exhibits 3-DP thru 8-DP, 1-VP, 2-VP, 1-SR thru 8-SR filed. Notice to parties.
May 2, 1969	Court entered order dismissing the request for review, filed November 27, 1968, and vacating, as moot, the trial commissioner's order of November 20, 1968. Copy to parties.
May 21, 1969	Transcript of testimony (1 volume) taken at Washington, D. C. on April 21, 1969,

Date	Proceedings
	together with plaintiff's exhibit 15-SR, defendant's exhibits 18-MT, 19-MT, 20-MT, 9-SR, 10-SR and 11-SR filed. Notice to parties.
May 21, 1969	Commissioner's order closing proof, etc. filed. Copy to parties.
Jun. 2, 1969	Defendant's exhibit 12-SR (omitted when transcript was filed on May 21, 1969) filed. Notice to parties.
Jun. 19, 1969	Plaintiff's motion for extension of time (to July 21, 1969) to file requested findings of fact and brief filed. Copies (2) to deft. ALLOWED JUL. 1, 1969.
Jul. 18, 1969	Plaintiff's requested findings of fact and brief filed. Copies (2) to deft.
Aug. 18, 1969	Defendant's motion for extension of time (to September 19, 1969) to file requested findings, etc. filed. Copies (2) to atty. ALLOWED SEP. 3, 1969, with no further extensions to be granted without a showing of exceptional circumstances.
Sep. 19, 1969	Defendant's motion for extension of time (to October 27, 1969) to file its requested findings, etc. filed. Copies (2) to atty. ALLOWED OCT. 6, 1969, but only to October 13, 1969. No further extensions will be granted.
Sep. 23, 1969	Plaintiff's objection to defendant's motion for extension of time filed. Copies (2) to deft.
Oct. 9, 1969	Defendant's motion for extension of time (to October 27, 1969) to file its requested findings, etc. filed. Copies (2) to atty. ALLOWED OCT. 10, 1969.
Oct. 27, 1969	Defendant's objections to plaintiff's requested findings of fact and defendant's

Date	Proceedings
	requested findings of fact filed. Copies (2) to atty.
Oct. 27, 1969	Defendant's brief to the commissioner filed. Copies (2) to atty.
Nov. 4, 1969	Plaintiff's motion to close record and briefing filed. Copies (2) to deft. DENIED AS MOOT: See Nov. 28, 1969.
Nov. 5, 1969	Defendant's motion for leave to file out of time supplements to its requested findings, etc. filed. Copies (2) to atty. ALLOWED, see Nov. 28, 1969.
Nov. 6, 1969	Plaintiff's objections to defendant's motion for leave to file out of time supplemental findings, etc. filed. Copies (2) to deft.
Nov. 12, 1969	Defendant's response to motion to close record, etc. and to objections to motion for leave to file supplemental findings, etc. Copies (2) to atty.
Nov. 28, 1969	Commr. entered order allowing Deft. 5 days hereof to file properly assembled & supplemented proposed findings, objections & brief (such filing to be in substitution of Deft's filings of Oct. 27, 1969), with Pltf. granted 20 days hereof to file reply brief & objections, and with Pltf's motion to close record denied as moot. Copy to parties.
Dec. 1, 1969	Plaintiff's request for review of trial commissioner's order (of November 28, 1969) filed. Copies (2) to deft.
Dec. 2, 1969	Defendant's reassembled objections to plaintiff's requested findings of fact and defendant's requested findings of fact filed. Copies (2) to atty.
Dec. 2, 1969	Defendant's reassembled brief to the commissioner filed. Copies (2) to atty.

Date	Proceedings
Dec. 8, 1969	Plaintiff's reply brief (to the commissioner) filed. Copies (2) to deft.
Jan. 9, 1970	Court entered order denying plaintiff's request for review (filed December 1, 1969). Copy to parties.
May 27, 1970	Commissioner's memorandum of conference filed. Copy to parties.
Jun. 15, 1970	Plaintiff's response to trial commissioner's post-trial conference memorandum and order filed. Copies (2) to deft.
Jun. 29, 1970	Defendant's supplemental memorandum pursuant to trial commissioner's order of May 27, 1970 filed. Copies (2) to atty.
Jul. 13, 1970	Plaintiff's reply to defendant's supplemental memorandum pursuant to trial Commissioner's order of May 27, 1970 filed. Copies (2) to deft.
Oct. 6, 1970	Stipulation reopening record to incorporate attached Treasury form filed, by defendant. Notice to comr.
Oct. 28, 1970	Commissioner's opinion and findings of fact filed. Copies (5) to pltf. and (15) to deft.
Nov. 19, 1970	Plaintiff's notice of intention to except to trial commissioner's report filed. Copies (2) to deft.
Nov. 24, 1970	Defendant's notice of intention to except to the commissioner's findings and recommendations filed. Copies (2) to atty.
Dec. 11, 1970	Plaintiff's motion for extension of time (to January 13, 1971) to file its exceptions and brief filed. Copies (2) to deft. ALLOWED DEC. 22, 1970.
Jan. 11, 1971	Plaintiff's exceptions and brief filed. Copies (13) to deft.

Date	Proceedings
Feb. 10, 1971	Defendant's motion for extension of time (to April 11, 1971) to file its exceptions, etc. filed. Copies (2) to atty. ALLOWED FEB. 12, 1971 in that an extension of time is granted to April 1, 1971 with no further extension to be granted except for illness or similar emergency.
Apr. 1, 1971	Defendant's motion for extension of time (to April 8, 1971) to file its exceptions and brief filed. Copies (2) to atty. ALLOWED APR. 2, 1971.
Apr. 8, 1971	Defendant's exceptions and brief filed. Copies (13) to atty.
Apr. 26, 1971	Plaintiff's motion for extension of time (to June 28, 1971) to file its reply brief filed. Copies (2) to deft. ALLOWED APR. 30, 1971, with no further extension to be granted except for illness or similar emergency.
Jun. 28, 1971	Plaintiff's reply brief filed. Copies (10) to deft.
Sep. 7, 1971	Defendant's motion for additional time for oral argument (two hours) filed. Copies (2) to atty. SEE ENTRY ON MOTION OF SEP. 9, 1971.
Sep. 9, 1971	Plaintiff's motion for additional time for oral argument filed. Copy to deft. ALLOWED SEP. 10, 1971 to the extent that plaintiff and defendant are granted one (1) hour for oral argument.
Sep. 23, 1971	Defendant's motion for additional time for argument (total of 1¾ hours) and that the issues be argued seriatim filed. Copies (2) to atty. DENIED SEP. 24, 1971.
Sep. 24, 1971	Defendant's motion for leave to file supplemental brief filed. Copies (2) to atty. ALLOWED SEP. 27, 1971 and filed.

Date	Proceedings
Sep. 27, 1971	Defendant's supplemental brief filed. Copies (12) to atty.
Sep. 30, 1971	Plaintiff's motion for leave to file reply to defendant's supplemental brief filed. Copies (2) to deft. ALLOWED SEP. 30, 1971.
Sep. 30, 1971	Plaintiff's reply to supplemental brief for the United States filed. Copies (4) to deft.
Oct. 7, 1971	Argued and submitted on the merits.
Oct. 18, 1971	Court entered order re supplemental briefs (due on: Nov. 5, 1971, Nov. 16, 1971 and Nov. 24, 1971). Copy to parties.
Nov. 5, 1971	Plaintiff's supplemental brief filed. Copies (2) to deft.
Nov. 16, 1971	Defendant's supplemental brief filed. Copies (2) to atty.
Nov. 24, 1971	Plaintiff's reply brief filed. Copies (2) to deft.
Feb. 18, 1972	Judgment for plaintiff, together with interest as provided by law, on the seven enumerated claims, with the amount of recovery to be determined pursuant to Rule 131(c) and with plaintiff's recovery subject to the two enumerated setoffs raised by defendant as set forth in the opinion. Opinion Per Curiam. Dissenting opinion by Judge Davis, in which Senior Judges Laramore and Durfee join in part and in which Judge Nichols joins. Dissenting opinion by Judge Nichols.
Jul. 19, 1972	Notice of filing (defendant) in Supreme Court of a petition for writ of certiorari (on July 17, 1972) No. 72-90. filed.
Oct. 27, 1972	Order of the Supreme Court, dated October 24, 1972, allowing certiorari filed.

In the
United States Court of Claims

[Caption Omitted]

Petition

(Filed May 7, 1965)

To the Honorable, the Chief Judge and the Associate Judges of the United States Court of Claims:

Plaintiff herein, Chicago, Burlington & Quincy Railroad Company, respectfully alleges:

1. Plaintiff, a corporation organized and existing under the laws of the State of Illinois, having its principal offices located at 547 West Jackson Boulevard, Chicago, Illinois, is, and at all times here pertinent was, engaged in the business of operating as a common carrier by rail in interstate commerce subject to the jurisdiction of the United States Interstate Commerce Commission (hereinafter referred to as the "I.C.C.").

2. This suit and the causes of action herein set forth arise under the Internal Revenue laws of the United States of America, and in particular, under the provisions of Chapter 1 of the Internal Revenue Code of 1954 (hereinafter referred to as "the Code"), Title 26, United States Code. Jurisdiction to hear and determine these causes of action at this time is conferred upon this Court by §§ 6532 (a), 7422(a), and 7851(a)(6)(C)(iv) of the Code, and by §§ 2401 and 2501 of the Judicial Code, Title 28, United States Code. Jurisdiction of the subject matter is conferred upon this Court by § 1491 of Title 28, United States Code.

3. This suit is brought to recover $492,290.25 (or such other amount as may be found legally due) of unrefunded Federal income tax, plus $3,105.77 in deficiency interest paid by plaintiff into the Treasury of the United States for its tax calendar year 1955, plus 6% per annum statutory interest on both sums as provided by law.

4. Plaintiff timely filed its Federal income tax return for 1955 with the United States District Director of Internal Revenue, Chicago, Illinois, and paid the tax shown by such return to be due for the year 1955 in the following amounts and on or about the dates hereinafter indicated:

Taxable Year	Date of Payment	Amount of Tax Paid
1955	September 15, 1955	$ 445,000.00
	December 15, 1955	445,000.00
	March 15, 1956	5,151,000.00
	June 15, 1956	4,799,051.48
Total		$10,840,051.48

Upon audit of plaintiff's Federal income tax return for 1955, the Secretary of the Treasury or his delegate (hereinafter referred to as "the Commissioner") determined plaintiff's Federal income tax liability for 1955 was $11,145,531.66 and plaintiff accordingly was assessed with, and on or about August 16, 1957, paid into the Treasury of the United States, additional Federal income taxes for 1955 totaling $305,480.18, plus $20,458.80 of deficiency interest. Of the foregoing total tax of $11,145,531.66, plus $20,458.80 of deficiency interest, paid by plaintiff into the Treasury of the United States only $256,349.64 in tax and $17,353.03 in deficiency interest have ever been refunded to plaintiff.

5. Plaintiff at all times here pertinent, including but not limited to the tax calendar year 1955, has kept its corporate books of account in accordance with the rules and regulations prescribed by the I.C.C. which included the maintenance of its books of account on the basis of the calendar year commencing January 1 in accordance with the accrual method of accounting. Plaintiff has uniformly filed its Federal income tax returns in conformity with the accounting methods upon which its corporate books of account were kept in these respects, i.e., on the basis of the calendar year commencing January 1 and pursuant to the accrual method of accounting. Certain of plaintiff's property accounts, including I.C.C. Account 9—Rails, both for I.C.C. and for Federal income tax purposes during 1955 and all other pertinent times were uniformly maintained on the retirement-betterment method of accounting for depreciation.

6. In determining the Federal income tax liability of plaintiff for 1955, the Commissioner erred by illegally, erroneously, and wrongfully failing and refusing to allow plaintiff:

(a) an appropriate deduction for depreciation totaling $52,789.22 suffered in 1955 on certain depreciable property held throughout 1955 by plaintiff for use in its trade or business and acquired by plaintiff prior to June 22, 1954,

through donations as contributions to its capital from various States or political subdivisions thereof.

(b) appropriate tax treatment under § 1231 of the Code for some $211,584.09 of excess salvage recovered in 1955 upon ordinary retirements made from groups of equipment which had been placed on a remaining life basis, as of January 1, 1929, and to which since January 1, 1929, no new equipment had been added.

(c) appropriate tax treatment under § 1231 of the Code for some $83,186.35 of proceeds realized by plaintiff in 1955 by reason of the destruction of certain of plaintiff's rolling stock in that year on railroad lines other than plaintiff's.

(d) appropriate deductions totaling $140,808.00 for the costs incurred in 1955 in effecting the welding together of 39-foot lengths of steel rail to form 78-foot lengths placed in service in 1955.

(e) appropriate deductions from gross income totaling $121,826.70 representing sums accrued and paid by plaintiff in 1955 for the purpose of protecting and maintaining plaintiff's rail right-of-way and track in operable condition.

(f) appropriate tax treatment under § 1341 of the Code, as retroactively amended by § 60 of Public Law 85-866, officially entitled the Technical Amendments Act of 1958 (72 Stat. 1606, 1647-1648, 26 U.S.C. § 1341) enacted September 2, 1958, of certain repayments made in 1955 by plaintiff to the United States Government of transportation charges collected by plaintiff from the United States in earlier years under claim of right and appropriate Federal income and/or excess profits taxes paid thereon for such earlier years.

7. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(a) are as follows:

(a) Prior to June 22, 1954, plaintiff acquired certain facilities, donated as contributions to its corporate capital by various States or political subdivisions thereof. These contributed facilities were properly includible in plaintiff's depreciation basis for roadway properties (i.e., I.C.C. Accounts 3 (Grading), 6 (Bridges), 27 (Signals), and 39 (Public Improvements)), and as such were subject to depreciation under the straight-line method. Nevertheless the Commissioner has wrongfully excluded the costs of such

contributed facilities from plaintiff's depreciable asset basis in computing plaintiff's Federal income tax liability.

(b) The Commissioner by reason of his foregoing action has wrongfully deprived plaintiff of additional depreciation deductions for 1955 of $52,789.22, and thereby wrongfully caused plaintiff to overpay its Federal income tax for 1955, as properly computed, by $27,450.39 ($52,789.22 x 52%).

(c) The donations improperly excluded from plaintiff's investment accounts by the Commissioner were as follows:

	Account 3 (Grading)	Account 6 (Bridges)	Account 27 (Signals)	Account 39 Public Improvements
	$5,850.78	$1,528,403.54	$548,876.82	$63,009.39
Rate of Straight-Line Depreciation	2.29%	2.14%	3.33%	2.65%
Amount of Additional Depreciation	$133.98	$32,707.84	$18,277.60	$1,669.80

8. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(b) are as follows:

(a) Plaintiff upon its disposition through normal retirements during 1955 of certain depreciable assets realized $211,584.09 in excess of such assets' adjusted tax basis for gain. The assets upon which this excess salvage was realized in 1955 comprised units of rolling stock equipment which had been placed on a remaining life basis as of January 1, 1929, no new equipment being added to this group of units after January 1, 1929.

(b) The $211,584.09 so realized in 1955 by plaintiff in excess of its adjusted tax basis for gain upon its disposition through normal retirements in 1955 of the assets in question from its closed equipment accounts frozen as to additions since January 1, 1929, was erroneously taxed by the Commissioner as ordinary income instead of gain taxable as provided in § 1231.

(c) Plaintiff's realization in 1955 of this salvage in excess of that originally and properly estimated as of January 1, 1929, was due to price rises resulting from long-term inflationary trends and not from originally incorrect estimates of the equipment's useful economic life in plaintiff's hands.

(d) The amount of tax paid by plaintiff through treat-

ing excess salvage as ordinary income was $110,023.73 ($211,584.09 x 52%), whereas the proper tax computed at capital gains rate was $52,896.02 ($211,584.09 x 25%). Plaintiff has thus overpaid its tax on this count by $57,-127.71.

9. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(c) are as follows:

(a) During 1955, certain of plaintiff's freight cars were destroyed by casualty while in the possession of other railroad corporations. Plaintiff received a total of $83,-186.35 as compensation for its losses from the other railroads upon whose lines the casualties were suffered.

(b) All of plaintiff's equipment here in issue had been certified for amortization under § 124A of the Internal Revenue Code of 1939, or § 168 of the Code to the following extent:

Car Number	Percent Amortized at Time of Casualty Loss
61794	70%
60860	70%
18317	80%
60309	70%
171315	70%
76255	70%
17914	80%
61283	70%
76247	70%
17643	80%
18587	70%
18374	80%
60798	70%

(c) The Commissioner has erroneously classified as ordinary income so much of the § 1231 gain realized by plaintiff from the receipt of compensation from the carriers upon the lines of which the casualties to plaintiff's freight cars occurred as was equal to the difference between the amortization allowed up to the dates of the casualties and the amount of normal straight-line depreciation which would have been otherwise allowable.

(d) Plaintiff's freight cars so destroyed "off-line" were neither sold nor exchanged within the meaning and

intendment of § 1238 of the Code. Taxpayer is justly and properly entitled to treat its entire gain resulting from its receipt of compensation for the off-line wreck during 1955 of its freight cars as § 1231 gain taxable at capital gains rates of 25% instead of 52%.

(e) Plaintiff has paid tax of $14,595.85 upon its receipt of $83,186.35 by reason of the off-line destruction of the foregoing freight cars whereas the proper tax so payable by it was only $7,017.24. Accordingly, plaintiff, under this count, is entitled to recover $7,578.61 in tax.

10. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(d) are as follows:

(a) Plaintiff throughout 1955 and at all other times here material has been subject to the regulatory jurisdiction of the I.C.C. and has maintained its corporate books of account in accordance with the Uniform System of Accounts for Railroad Companies prescribed by the I.C.C.

(b) I.C.C. Account 9 is and was labeled "Rails" and in this Account plaintiff, as prescribed, has continuously recorded its investment in rail. The assets recorded in Account 9 at all times here pertinent have been subject to depreciation, both for I.C.C. and for Federal income tax purposes, under the retirement-betterment method. Where regularly employed, as has uniformly been done by plaintiff, the retirement-betterment method of accounting for depreciation serves accurately to reflect taxable income for Federal income tax purposes.

(c) Under the retirement-betterment method of accounting for depreciation no deduction is allowed or allowable for exhaustion, wear and tear or normal obsolescence suffered by property accounted for under this method until such time as individual units of property are either permanently retired or replaced in kind. Upon retirement without replacement the full cost or other tax basis of such property less salvage value is allowable as a depreciation deduction. Upon retirement by reason of replacement strictly in kind, the current cost of the replacement property is allowable as a depreciation deduction while the cost of the replaced property remains capitalized on the books. Upon retirement of property by reason of a replacement which constitutes a betterment, the cost of the replacement property is allowable as a depreciation deduction in an amount equal to the cost of effecting a replacement strictly

in kind, with the balance of the total replacement cost, i.e., the cost of effecting the betterment, being added on the books to the capitalized cost of the property replaced.

(d) Plaintiff in accounting for the cost of replacing rail has uniformly during 1955 and at all other times here material charged the gross cost of the new rail installed to capital account at current prices and at the same time credited the weight of the replaced rail multiplied by the same price per ton to capital account and charged operating expense with a like sum. The net effect has been that only the added weight of rail has been actually charged to capital account at current prices, as required by I.C.C. accounting instructions and the retirement-betterment method of accounting for depreciation for Federal income tax purposes. In consequence, the total amount reflected in Account 9 is not the current cost of the entire new length of rail laid but reflects rather a series of charges based on prices in effect when replaced rail was earlier installed at lesser weights.

(e) During 1955, plaintiff in a substantial number of instances replaced two 39-foot lengths of steel rail with one 78-foot length of rail. The standard length of rail bought from the steel mills was 39 feet and plaintiff completed the manufacturing process necessary to produce a rail of 78 feet in length by welding two 39-foot lengths together. The cost to plaintiff of effecting such weld was an integral part of the aggregate cost of acquiring rails 78 feet in length. This aggregate cost constituted the price of the replacement unit being substituted for two 38-foot length rails for purposes of applying the retirement-betterment method of accounting. Thus only that portion of the cost of effecting the welding together of two 39-foot lengths of steel rail into a single 78-foot length as was properly attributable to the increased pattern weight of rail installed over the rail removed constituted a betterment properly subject to being charged to capital account. The remaining cost of the weld was properly deductible as depreciation in the year incurred and placed in service.

(f) The Commissioner has erroneously and wrongfully capitalized the entire cost incurred by plaintiff in effecting the welding together of 39-foot lengths of rail to form 78-foot lengths of rail installed in 1955. The cost to plaintiff of effecting such welding together of rail installed

in 1955 was $155,748 and the Commissioner has capitalized this entire sum. In fact, only $14,940 of such $155,748 total cost was properly attributable to the increased pattern weight of welded rail installed in 1955 over unwelded rail replaced in that year, and so was properly chargeable to capital account. The remaining $140,808 of welding costs incurred by plaintiff in 1955 was properly chargeable to operating expense as an integral part of the cost per ton of welded new rail of the same pattern weight as the unwelded rail replaced. Accordingly, plaintiff is justly entitled under this count to a refund of income tax of $73,220.16 ($140,808 x 52%).

11. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(e) are as follows:

(a) During 1955 plaintiff incurred costs totaling $121,-826.70 for purposes of protecting and maintaining its rail right-of-way and track in operable condition and not for the purposes of improving or bettering such property.

(b) The expenditures here in question, which neither extended the normal life nor increased the capacity of the affected properties, were incurred in placing rip rap, strengthening dikes, levees, jetties and ditches, and otherwise controlling and channeling the flow of various surface waters.

(c) The amount of tax refund due plaintiff by reason of these expenditures is $63,349.88 ($121,826.70 x 52%).

12. The facts upon which plaintiff relies in support of the errors alleged in subparagraph 6(f) are as follows:

(a) During 1955, plaintiff, by reason of the Government's entitlement to land grant carriage rates on certain charges made for the rendition of transportation service in earlier years, was forced by action of the General Accounting Office (hereinafter referred to as the "GAO") to refund certain sums to the Federal Government. These overcharges had been returned as income by plaintiff in the earlier years when its right to receive payment first accrued and Federal tax thereon had been duly paid. Such overcharges were attributable to plaintiff's failure properly to accord the Government the special land grant rates to which the various shipments in question were ultimately determined to be entitled by the GAO.

(b) Section 1341 of the Code, as amended by § 60 of the Technical Changes Act of 1958, is mandatory in its

operations. Thus these land grant refunds made during 1955 by plaintiff to the Government must either be taken as a deduction in 1955 or excluded from income in the earlier years returned, whichever treatment affords plaintiff the greater tax benefit.

(c) Upon the audit of plaintiff's refund claim based upon § 1341, as amended, the Commissioner determined that plaintiff was justly entitled to recover $490,315.14 in tax out of a total claimed refund sought by plaintiff of $496,887.10.

(d) Despite the Commissioner's audit finding that plaintiff was entitled to recover $490,315.14 in tax on this issue, the sum of $222,448.20 in tax plus $41,115.30 in tax, or $263,563.50 in all, has been wrongfully and illegally withheld from plaintiff by the Commissioner. Plaintiff is justly entitled to recover not less than $263,563.50 in tax on this count.

13. Appropriate claims for refund on Form 843 were timely filed by plaintiff for its tax calendar year 1955 on or about February 16, 1959, with the United States District Director of Internal Revenue, Chicago, Illinois. All such refund claims have now been on file in excess of six months. The earliest final action denying recovery on these refund claims was taken by the Commissioner through the mailing to plaintiff under date of May 27, 1963, of statutory notices of disallowance. The reasons set forth by plaintiff in support of the said claims on Form 843 were substantially in accordance with the facts hereinabove alleged.

14. This suit is timely filed, i.e., more than six months after the due filing of appropriate refund claims and within two years of the date of any such claims' formal rejection by the Commissioner.

15. Plaintiff is the sole owner of the claims here sued upon, and no assignment or transfer thereof, or any part thereof, or interest therein, has been made by plaintiff.

16. No action on these claims has been taken by the Congress of the United States, or by any Department of the Government, except as hereinbefore set forth.

17. Plaintiff is justly entitled to recover the amounts claimed herein from the United States of America.

Wherefore, plaintiff prays judgment against the United States of America upon the facts and the law for the recovery of $492,290.25 in income taxes, plus $3,105.77 of

deficiency interest, plus interest on both sums at the rate of 6% per annum as provided for by law, and for such other and further relief as this Court may deem proper.

Respectfully submitted,
/s/ Robert T. Molloy
ROBERT T. MOLLOY
Counsel for Plaintiff
1527 New Hampshire Avenue, N. W.
Washington, D. C. 20036

Of Counsel:
ELDON MARTIN
RICHARD T. CUBBAGE
547 West Jackson Boulevard
Chicago, Illinois 60606

GERALD J. O'ROURKE, JR.
ROBERT E. SIMPSON
1527 New Hampshire Avenue, N. W.
Washington, D. C. 20036

IN THE UNITED STATES COURT OF CLAIMS

[Caption Omitted]

ANSWER

The defendant, United States of America, by its attorneys, John B. Jones, Jr., Acting Assistant Attorney General, and Sheldon P. Migdal, attorney, United States Department of Justice, denies all allegations of plaintiff's petition not admitted, qualified or expressly referred to below.

Further answering the petition, defendant:

1. Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 1.

2. Denies the allegations of the first and second sentences of paragraph 2. Admits the allegations of the third sentence of paragraph 2.

3. Admits the allegations of paragraph 3, except denies that plaintiff is entitled to recover.

4. Admits the allegations of paragraph 4, except denies knowledge or information sufficient to form a belief as to the truth of the allegations of the last sentence thereof.

5. Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 5.

6(a)-(f). Denies the allegations of paragraphs 6(a) through (f).

7(a). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 7(a) except denies the allegations of the last sentence thereof.

7(b) and (c). Denies the allegations of paragraphs 7(b) and (c).

8(a). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 8(a).

8(b). Denies the allegations of paragraph 8(b).

8(c). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 8(c).

8(d). Denies the allegations of paragraph 8(d).

9(a) and (b). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 9(a) and (b).

9(c)-(e). Denies the allegations of paragraphs 9(c) through (e).

10(a)-(e). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 10(a) through (e).

10(f). Denies the allegations of paragraph 10(f).

11(a)-(c). Denies the allegations of paragraphs 11(a) through (c).

12(a)-(c). Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 12(a) through (c).

12(d). Denies the allegations of paragraph 12(d).

13. Denies the allegations of paragraph 13, except admits that plaintiff filed eight claims for refund for 1955 on February 16, 1959, one claim on April 14, 1959, and two claims on May 29, 1959, all of which were disallowed on May 27, 1963.

14. Admits the allegations of paragraph 14.

15. Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 15.

16. Denies knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 16.

17. Denies the allegations of paragraph 17.

Further Defenses

As a further defense defendant alleges:

18. On its income tax return for 1955, plaintiff claimed a foreign tax credit for taxes paid to Mexico in the amount of $85,656.87. These taxes were imposed by Mexico on the daily rentals paid to plaintiff for use of its railroad cars by Mexican railroads in that nation.

19. This tax imposed by Mexico was not a creditable foreign tax within the meaning of Section 901 of the Internal Revenue Code of 1954. Thus, plaintiff was not entitled to a foreign tax credit for any part of the tax paid to Mexico in 1955.

20. Plaintiff did not realize any taxable income from sources within Mexico during the taxable year 1955. Section 862, Internal Revenue Code of 1954. Therefore, even if it should be determined that this tax imposed by Mexico was a creditable foreign tax within the meaning of Section 901 of the Internal Revenue Code of 1954, plaintiff is not entitled to any foreign tax credit for this Mexican tax by reason of the limitation on foreign tax credit provided in Section 904 of the Internal Revenue Code of 1954.

21. Through error, no deficiency in income tax was assessed against plaintiff in respect to the matters described in paragraph 18 through 20 hereof.

22. If all or any part of the issues raised in plaintiff's petition are determined in its favor, the amount of any overpayment determined for the taxable year in issue should be reduced by the additional income tax payable as a result of allowing the tax paid to Mexico as a deduction in accordance with the provisions of Section 164 of the Internal Revenue Code of 1954, rather than as a credit against the federal income tax under Section 901 of the Internal Revenue Code of 1954.

WHEREFORE, defendant, having fully answered plaintiff's petition, prays that it be dismissed with prejudice, that plaintiff take nothing in this suit and that defendant be allowed its costs herein.

JOHN B. JONES, JR.
Acting Assistant Attorney General

SHELDON P. MIGDAL
Attorney

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE

14 a & b Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts 17 a Acct. 6 Bridges	17 a Acct. 27 Signals	17 a Acct. 39 Public Imprv.	Total	15 Donor	16 Date of Agreement
Line Chicago to Aurora, Ill.								
Highway undercrossing, Br. 13.55	23171	1932	$ 1,668.88			$ 1,668.88	State of Illinois	10-30-30
Highway undercrossing, Br. 30.52	24530	1932	52,957.80			52,957.80	State of Illinois	11-13-33
Highway undercrossing, Br. 11.53	26003	1937	58,791.42			58,791.42	State of Illinois	3-3-36
Raise River Bridge 11.39 acct. of Br. 11.53	26003	1937	9,752.67			9,752.67	State of Illinois	3-3-36
Highway undercrossing, Br. 24.68	16450	1936	22,641.31			22,641.31	State of Illinois	12-30-30
Highway undercrossing, Br. 31.60	25048	1936	33,254.12			33,254.12	State of Illinois	9-19-34
Highway crossing signals—Western Springs	41419	1949		$ 7,142.16		7,142.16	Cook County	2-17-48
Highway crossing signals—Berwyn	45106	1949		13,977.27		13,977.27	Cook County	9-11-47
Aurora—Graham Jct., Ill.								
Highway undercrossing, Br. 46.65	25049	1936	33,863.62			33,863.62	State of Illinois	8-14-34
Highway undercrossing, Br. 83.66	25397	1936	32,871.51			32,871.51	State of Illinois	2-13-35
Highway undercrossing, Br. 129.47	8385	1924	4,170.68			4,170.68	State of Illinois	4-10-24
Highway undercrossing, Br. 154.67	8380	1924	5,563.46			5,563.46	State of Illinois	4-10-24
Highway undercrossing, Br. 202.50	9209	1927	7,402.49			7,402.49	State of Illinois	12-2-25
Graham, Ill. to Ill.—Iowa State Line								
Highway crossing signals, Monmouth	84869	1954		11,875.54		11,875.54	State of Illinois	3-9-53
Galesburg Terminal, Ill.								
Highway Crossing Signals	45552	1947		5,697.96		5,697.96	State of Illinois	6-10-47
Aurora—Wisconsin State Line, Ill.								
Sugar Grove Highway Crossing Signals	25712-3	1936		980.21		980.21	State of Illinois	1-26-35
Highway undercrossing, Br. 44.68	26071	1937	47,648.92			47,648.92	State of Illinois	7-2-36
Highway undercrossing, Br. 122.16	24081	1934	10,276.19			10,276.19	State of Illinois	10-20-33
Highway crossing signals (Blanding)	41426	1943		3,494.92		3,494.92	State of Illinois	9-12-41
Highway overcrossing, Br. 98.70	18550	1929			$19,340.01	19,340.01	State of Illinois	9-8-27
Highway crossing signals (Rochelle)	48301	1953		8,314.73		8,314.73	State of Illinois	10-3-52
Aurora—Streator, Paw Paw—Sterling, Ill.								
Highway undercrossing, Br. 41.25	29035	1938	4,855.40			4,855.40	State of Illinois	1-5-38
Highway crossing signals (Serena)	29455	1939		2,759.87		2,759.87	State of Illinois	10-24-38
Highway undercrossing, Br. 42.62A	23655	1935	14,542.18			14,542.18	State of Illinois	9-29-34
Highway crossing signals (Yorkville)	45597	1948		3,141.70		3,141.70	State of Illinois	9-23-47
Streator—Kasbeer, Mendota—Denrock, Ill.								
Highway Crossing signals, Van Orin, Ohio	25712-1	1936		$ 2,637.37		$ 2,637.37	State of Illinois	1-26-35
Highway Crossing signals, Deer Grove	40491	1941		1,812.24		1,812.24	State of Illinois	7-11-40
Highway Crossing signals, Ohio	40495	1941		1,742.78		1,742.78	State of Illinois	7-11-40
Highway Crossing signals, Streator	45097	1947		1,406.26		1,406.26	State of Illinois	4-8-47
Highway Crossing signals, Prophetstown	45911	1949		959.91		959.91	State of Illinois	2-5-48
Highway Crossing signals, Walnut	29451	1940		3,057.49		3,057.49	State of Illinois	10-24-38

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(*Continued*)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Davis Jct.—Rockford, Ill.								
Highway Crossing Signals, Davis Jct.	26821	1936		694.94		694.94	State of Illinois	5-16-34
Highway Crossing Signals, Rockford	46260	1950		2,215.49		2,215.49	State of Illinois	8-31-28
Overhead Highway Bridge, Rockford	46981	1952			$ 2,349.12	2,349.12	City of Rockford	11-3-50
Galesburg—Quincy, Ill.								
Highway undercrossing, Br. 236.99	25056	1935	$27,509.81			27,509.81	State of Illinois	8-8-34
Highway undercrossing, Br. 177.65	24683	1934	18,756.44			18,756.44	State of Illinois	11-13-33
Highway undercrossing, Br. 247.27	8312	1924	5,278.19			5,278.19	State of Illinois	11-27-33
Highway undercrossing, Br. 226.26	20904	1930	6,045.45			6,045.45	State of Illinois	2-1-23
Crossing Signals (Ellington, Bushnell, Quincy)	25712	1936		4,826.81		4,826.81	State of Illinois	1-26-35
Crossing Signals (Macomb)	45474	1948		610.00		610.00	State of Illinois	6-18-47
Galesburg—Savanna, Ill.								
Crossing Signals (Fulton, Opheim)	29460	1939		3,251.42		3,251.42	State of Illinois	10-24-38
Crossing Signals (Colona)	29467	1939		1,390.00		1,390.00	State of Illinois	10-25-38
Crossing Signals (Briar Bluff)	26740	1937		625.82		625.82	State of Illinois	11-5-36
Crossing Signals (5 locations)	25712	1936		6,781.84		6,781.84	State of Illinois	1-26-35
Crossing Signals (Rock Island, Moline)	40132	1941		34,995.98		34,995.98	State of Illinois	7-25-39
Crossing Signals (Rio)	45463	1948		290.75		290.75	State of Illinois	6-11-47
Crossing Signals (Hillsdale)	46767	1950		2,069.00		2,069.00	State of Illinois	10-13-49
Crossing Signals (M.P. 33.81 and 69.03)	47445	1951		6,184.90		6,184.90	Whiteside County	2-1-51
Galva—New Boston								
Highway undercrossing, Br. 4.29	24047	1932	2,573.79			2,573.79	State of Illinois	5-23-32
Crossing Signals (Viola)	25712	1936		1,219.27		1,219.27	State of Illinois	1-26-35
Galesburg—Peoria, Buda—Rushville, Ill.								
Highway undercrossing, Br. 21.78	16809	1927	1,551.80			1,551.80	State of Illinois	7-9-26
Crossing Signals (4 locations)	25712	1936		4,832.04		4,832.04	State of Illinois	1-26-35
Crossing Signals (Farmington-Lewistown)	29456	1939		4,676.30		4,676.30	State of Illinois	10-24-38
Overhead Viaduct, Br. 1.91	16815	1927			17,438.80	17,438.80	State of Illinois	7-12-26
Crossing Signals (Bryant)	40489	1940		$ 1,419.04		$ 1,419.04	State of Illinois	7-11-40
Crossing Signals (Lewistown)	48362	1953		2,811.99		2,811.99	State of Illinois	10-7-52
Lewistown—Fairview, Ill.								
Crossing Signals (Cuba)	40490	1940		1,575.15		1,575.15	State of Illinois	7-11-40
Illinois Junction—Quincy								
Highway undercrossing, Br. 15.44	23102	1931	$ 2,311.80			2,311.80	State of Illinois	6-5-31
Crossing Signals (Carthage)	25712	1936		1,497.77		1,497.77	State of Illinois	1-26-35
Crossing Signals (Ursa)	29453	1939		1,810.29		1,810.29	State of Illinois	10-24-38
Concord—E. Alton, Ill.								
Crossing Signals (Chapin)	25712	1936		1,088.22		1,088.22	State of Illinois	1-26-35
Crossing Signals (Piasa, Alsey)	29454	1939		4,598.42		4,598.42	State of Illinois	10-24-38
Crossing Signals (Riggston)	40543	1940		1,307.26		1,307.26	State of Illinois	7-11-40
Crossing Signals (Medora)	40497	1940		1,642.96		1,642.96	State of Illinois	7-11-40
Crossing Signals (Winchester)	47718	1951		714.74		714.74	State of Illinois	3-16-51

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Beardstown—Rio, Ill.								
Highway undercrossing, Br. 185.38	16093	1926	3,037.03			3,037.03	State of Illinois	1-8-26
Crossing Signals (3 locations)	25712	1936		3,817.73		3,817.73	State of Illinois	1-26-35
Crossing Signals (Waltonville)	25712	1936		2,952.24		2,952.24	State of Illinois	1-26-35
Overhead viaduct, Br. 135.17	16810	1927			$ 2,213.33		State of Illinois	8-25-26
Crossing Signals, Table Grove	40925	1941		4,807.02		4,807.02	State of Illinois	2-14-41
Crossing flood lights	44592	1946		563.12		563.12	Fulton County	11-23-45
Concord—Centralia, Ill.								
Highway undercrossing, Br. 106.21	26235	1936	3,304.62			3,304.62	State of Illinois	1-7-36
Crossing Signs (Burnett)	26453	1937		647.92		647.92	State of Illinois	7-2-36
Crossing Signs (Smithboro)	41031	1942		3,053.32		3,053.32	State of Illinois	4-17-41
Centralia—Metropolis, Ill.								
Highway undercrossing, Br. 161.12	8365	1924	2,700.38			2,700.38	State of Illinois	
Crossing Signals (Mermet)	29099	1939		1,309.31		1,309.31	State of Illinois	12-16-37
Crossing Signals (Sesser)	40496	1941		4,565.06		4,565.06	State of Illinois	7-11-40
Raise Br. for undercrossing, Br. 3.41	41536	1941	463.45			463.45	State of Illinois	11-25-41
Flood lights at crossing (W. Frankfort)	41201	1942		1,072.46		1,072.46	State of Illinois	7-11-41
Crossing Signals (W. Frankfort)	45161	1947		$ 2,343.80		$ 2,343.80	State of Illinois	4-26-47
Crossing Signals (Waltonville, Centralia)	25712	1936		2,952.24		2,952.24	State of Illinois	1-26-35
Crossing Signals (W. Frankfort)	48399	1953		2,253.04		2,253.04	State of Illinois	11-6-52
Mediapolis—Washington, Ia.								
Crossing Signals—Mediapolis	40501	1940		1,003.51		1,003.51	State of Iowa	5-16-40
Albia—Des Moines								
Crossing Signals (Knoxville)	27986	1938		2,964.79		2,964.79	State of Iowa	1-4-38
Crossing Signals (Albia) (Harvey)	29588	1939		4,648.36		4,648.36	State of Iowa	8-22-39
Crossing Signals (Des Moines)	29591	1940		2,113.76		2,113.76	State of Iowa	1-8-40
Crossing Signals (Des Moines)	29590	1940		1,843.71		1,843.71	State of Iowa	1-8-40
Burlington—Creston, Iowa								
Highway crossing, Br. 225.25	26742	1937	$35,971.89			35,971.89	State of Iowa	12-22-36
Highway undercrossing, Br. 333.77	24682	1937	26,043.76			26,043.76	State of Iowa	3-17-34
Crossing Signals, Agency City	27904	1938		2,760.72		2,760.72	State of Iowa	12-15-38
Crossing Signals (Mt. Pleasant)	29570	1939		3,390.37		3,390.37	State of Iowa	8-22-39
Highway Undercrossing, Br. 244.54	29772	1940	31,453.66			31,453.66	State of Iowa	1-23-40
Highway Undercrossing, Br. 255.49	24681	1934	20,587.00			20,587.00	State of Iowa	4-4-34
Highway viaduct crossing, Br. 208.61	22529	1930			$ 4,019.14	4,019.14	State of Iowa	8-2-30
Highway undercrossing, Br. 334.07	19539	1928	7,815.54			7,815.54	State of Iowa	4-17-28
Crossing Signs (Chillicothe)	29571	1940		3,460.34		3,460.34	State of Iowa	8-22-39
Crossing Signs (Chillicothe)	29572	1940		4,036.02		4,036.02	State of Iowa	8-22-39
Crossing Signs (Albia)	29373	1940		3,034.46		3,034.46	State of Iowa	8-22-39
Crossing Signs (Russell)	29574	1940		3,826.94		3,826.94	State of Iowa	8-22-39
Crossing Signs (Thayer)	29575	1940		3,541.70		3,541.70	State of Iowa	8-22-39
Crossing Signs (Mt. Pleasant)	40891	1941		4,379.07		4,379.07	State of Iowa	2-18-41

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Creston—Missouri River								
Highway undercrossing, Br. 393.66	26007-1	1937	39,598.26			39,598.26	State of Iowa	3-3-36
Crossing Signals (Nodaway)	27987	1938		3,147.86		3,147.86	State of Iowa	1-4-38
Crossing Signals (Prescott)	29576	1939		2,565.52		2,565.52	State of Iowa	8-22-39
Crossing Signals (Brooks)	48635	1954		2,953.63		2,953.63	Adams County, Ia.	4-6-53
Cumberland—Mo. State Line, Ia.								
Crossing Signals (Creston)	25984	1939		$ 2,215.26		$ 2,215.26	State of Iowa	8-22-39
Crossing Signals (Kent)	29585	1940		1,519.86		1,519.86	State of Iowa	1-8-40
Crossing Signals (Bedford)	29586	1940		2,413.30		2,413.30	State of Iowa	1-8-40
Red Oak—Hamburg, Ia.								
Crossing Signals (Riverton)	29583	1939		2,455.96		2,455.96	State of Iowa	8-22-39
Viele—Bloomfield, Ia.								
Crossing Signals (Viele)	44758	1947		981.17		981.17	State of Iowa	9-26-46
Crossing Signals (Donnellson)	29596	1940		2,626.77		2,626.77	State of Iowa	8-22-39
Sedan—Humeston, Ia.								
Highway undercrossing, Br. 117.21	16814	1927	$ 1,553.31			1,553.31	State of Iowa	11-29-26
Highway undercrossing, Br. 114.07	6832	1923	1,488.50			1,488.50	State of Iowa	11-23-23
Crossing Signals (Centerville)	29594	1940		1,896.21		1,896.21	State of Iowa	8-22-39
Burlington—Mo. State Line, Ia.								
Crossing Signals (Montrose)	23732	1932		476.67		476.67	State of Iowa	5-17-32
Crossing Signals (Bullard)	29579	1940		2,470.94		2,470.94	State of Iowa	8-22-39
Crossing Signals (Becks Siding)	29578	1940		2,400.47		2,400.47	State of Iowa	1-8-40
Crossing Signals (Ft. Madison)	29580	1940		1,756.34		1,756.34	State of Iowa	8-22-39
Council Bluffs, Ia.								
Highway Undercrossing, Br. 492.19	26516	1936	1,454.00			1,454.00	City of Council Bluffs	7-31-36
Highway Undercrossing, Br. 493.00	26515	1936	2,679.13			2,679.13	City of Council Bluffs	7-31-36
Bridge over Indian Creek—Br. 492.19B	16060	1951	3,448.24			3,448.24	U.S. Government	9-2-48
Villisca—Mo. State Line, Ia.								
Crossing Signals (Clarinda)	29593	1939		2,065.19		2,065.19	State of Iowa	8-22-39
Crossing Signals (Clarinda)	40544	1941		1,242.22		1,242.22	State of Iowa	9-9-40
Chariton—Mo. State Line, Ia.								
Highway Undercrossing, Br. S 44.24	20891	1929	4,642.70			4,642.70	State of Iowa	10-16-28
Concordia—Nebraska State Line, Kansas								
Highway undercrossing, Br. 49.20	31826	1939	7,891.78			7,891.78	State of Kansas	6-25-38
LaClede—Unionville, Mo.								
Highway Undercrossing, Br. 182.25	16808	1927	$ 5,101.63			$ 5,101.63	State of Missouri	2-7-27
No. St. Louis—Iowa State Line								
Highway Undercrossing, Br. 9.75	23176	1932	36,996.12			36,996.12	City of St. Louis	6-2-31
Highway Undercrossing, Br. 9.92	23160	1932	43,408.82			43,408.82	City of St. Louis	6-2-31

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Hannibal—Brookfield, Mo.								
Highway Undercrossing, Br. 12.21	22511	1931	8,686.66			8,686.66	State of Missouri	5-2-30
Highway Undercrossing, Br. 10.47	26006	1937	28,885.05			28,885.05	State of Missouri	11-11-35
Highway Undercrossing, Br. 6.92	9022	1926	4,189.83			4,189.83	State of Missouri	11-11-35
Highway Undercrossing, Br. 25.44	9204	1926	7,523.69			7,523.69	State of Missouri	11-11-35
Crossing Signals (Lingo)	44953	1948		$ 2,857.92		2,857.92	State of Missouri	9-16-46
Crossing Signals (Anabel)	46786	1950		4,530.49		4,530.49	State of Missouri	7-31-49
Old Monroe—Francis, Mo.								
Crossing Signals, Wellsville	47523	1950		5,040.86		5,040.86	State of Missouri	12-2-50
Cameron Jct.—No. Kansas City								
Brookfield—St. Joseph, Mo.								
Highway Undercrossing, Br. 209.21	26004	1937	28,557.16			28,557.16	State of Missouri	11-26-35
Highway Undercrossing, Br. 211.03	26005	1937	43,851.58			43,851.58	State of Missouri	12-19-33
Highway Undercrossing, Br. 109.46A	24678	1935	16,347.11			16,347.11	State of Missouri	12-19-33
Highway Undercrossing, Br. 170.48	16347	1927	6,530.23			6,530.23	State of Missouri	1-2-27
Highway Undercrossing, Br. 135.48	16800	1928	6,611.77			6,611.77	State of Missouri	10-23-26
Crossing Signals (Phelps)	45062	1948		4,447.48		4,447.48	State of Missouri	12-21-46
Crossing Signals (No. Kansas City)	48681	1953		1,651.89		1,651.89	State of Missouri	5-4-53
Crossing Signals (No. Kansas City)	48674	1954		5,661.88		5,661.88	City of Kansas City	5-29-53
St. Joseph—Iowa State Line, Mo.								
Highway Undercrossing, Br. 77.16	26265	1937	5,479.03			5,479.03	State of Missouri	11-11-35
Highway Undercrossing, Br. S-86.91	6324	1924	1,443.87			1,443.87	State of Missouri	11-20-24
Bridge over High Creek, Br. 136.20	46358	1950	39,669.33			39,669.33	U.S. Government	5-19-49
Crossing Signals (Craig)	48196	1953		9,125.97		9,125.97	State of Missouri	5-11-52
Wyoming State Line—Billings, Montana								
Highway Undercrossing, Br. 7.05	34127	1943	4,903.52			4,903.52	State of Montana	8-20-41
Crossing Signals (Wyola)	38838	1954		4,692.69		4,692.69	State of Montana	12-18-52
Plattsmouth—Lincoln, Nebr.								
Highway undercrossing, Br. 54.82	32304	1938	$57,758.66			$57,758.66	State of Nebraska	9-24-37
Crossing Signals (Lincoln)	32780	1939		$ 3,843.91		3,843.91	State of Nebraska	6-14-38
Highway Undercrossing, Br. 55.58	32303	1939	51,643.80			51,643.80	State of Nebraska	6-1-38
Highway Undercrossing, Br. 7.07A	34119	1941	7,051.00			7,051.00	State of Nebraska	5-10-41
Ashland—Prague, Nebr.								
Highway Undercrossing, Br. 0.57	30272	1931	1,499.36			1,499.36	State of Nebraska	5-16-31
Ashland—Laketon, Nebr.								
Crossing Signals (Winslow)	32935	1939		1,911.37		1,911.37	State of Nebraska	6-14-38
Crossing Signals (Fremont)	32060	1936		1,458.27		1,458.27	State of Nebraska	7-14-36
Crossing Signals (Fremont)	32061	1936		1,058.62		1,058.62	State of Nebraska	7-15-36
Crossing Signals (Walthill)	33896	1941		2,182.40		2,182.40	State of Nebraska	8-14-40
Laketon—O'Neill, Nebr.								
Highway Undercrossing, Br. 26.26	11251	1926	1,754.51			1,754.51	State of Nebraska	4-14-25
Crossing Signals (Osmond)	32327	1937		1,242.03		1,242.03	State of Nebraska	12-15-37

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Lincoln—Kenesaw, Nebr.								
Crossing Signals (Lincoln)	33333	1939		3,205.58		3,205.58	State of Nebraska	3-4-39
Crossing Signals (Lincoln)	33334	1939		3,311.08		3,311.08	State of Nebraska	3-4-39
Highway Undercrossing, Br. 156.42	31069	1936	76,861.62			76,861.62	State of Nebraska	12-4-33
Highway Undercrossing, Br. 137.82	8874	1923	4,417.34			4,417.34	State of Nebraska	Verbal
Crossing Signals (Ingleside)	32329	1938		1,232.04		1,232.04	State of Nebraska	12-15-36
Crossing Signals (Kenesaw)	33461	1940		4,200.60		4,200.60	State of Nebraska	6-19-39
Crossing Signals (Dorchester)	34331	1947		6,434.50		6,434.50	State of Nebraska	8-14-41
Lincoln Terminal, Nebr.								
Highway Undercrossing, Br. 1.60	31120	1936	2,401.08			2,401.08	State of Nebraska	1-4-35
Crossing Signals (Lincoln)	30990	1934		1,147.51		1,147.51	State of Nebraska	8-26-33
Lincoln—Ravenna, Nebr.								
Highway Undercrossing, Br. 55.90	32730	1939	48,623.63			48,623.63	State of Nebraska	8-8-38
Crossing Signals, (Grand Island)	32880	1939		2,871.52		2,871.52	State of Nebraska	6-14-38
Highway Undercrossing, Br. 19.54	30619	1933	6,171.00			6,171.00	State of Nebraska	10-25-32
Seward—Columbus, Nebr.								
Highway Undercrossing, Br. 66.42	31908	1936	$15,166.07			$15,166.07	State of Nebraska	4-13-36
Aurora—Sargent, Nebr.								
Crossing Signals, (Farwell)	33330	1940		$ 1,564.41		1,564.41	State of Nebraska	3-4-39
Highway Undercrossing, Br. 14.01	52	1923	4,348.94			4,348.94	State of Nebraska	Verbal
Crossing Signals (Central City)	32325	1937		1,249.15		1,249.15	State of Nebraska	12-15-36
Crossing Signals (Aurora)	32330	1937		1,352.61		1,352.61	State of Nebraska	12-15-36
Salo—Lester, Nebr.								
Crossing Signals (Endicott)	37809	1950		2,476.17		2,476.17	State of Nebraska	6-6-49
Crossing Signals (Dawson)	33332	1939		3,135.08		3,135.08	State of Nebraska	3-4-39
Crossing Signals (Diller)	32884	1939		3,431.45		3,431.45	State of Nebraska	3-4-39
Crossing Signals (Wymore)	33331	1940		4,101.90		4,101.90	State of Nebraska	6-12-39
Crossing Signals (Krider)	33473	1940		1,830.01		1,830.01	State of Nebraska	6-19-39
Highway Undercrossing, Br. 55.76	1006	1927	5,715.67			5,715.67	State of Nebraska	6-7-26
Crossing Signals (Red Cloud)	38094	1951		925.34		925.34	State of Nebraska	10-18-50
Crossing Signals (Odell)	37751	1950		3,705.48		3,705.48	State of Nebraska	2-14-50
Crossing Signals (Guide Rock)	37752	1950		4,239.02		4,239.02	State of Nebraska	2-14-50
Crossing Signals (Endicott)	37809	1950		2,562.97		2,562.97	State of Nebraska	6-1-49
Crossing Signals (Endicott)	38411	1951		4,221.35		4,221.35	State of Nebraska	4-17-50
Lincoln—Table Rock, Nebr.								
Crossing Signals (Roca)	32321	1937		1,781.86		1,781.86	State of Nebraska	12-15-36
Kenesaw—McCook, Nebr.								
Crossing Signals, (Edison)	32936	1939		3,879.59		3,879.59	State of Nebraska	6-14-38
Crossing Signals, (Arapahoe)	32324	1937		1,411.60		1,411.60	State of Nebraska	12-15-36
Crossing Signals, (Oxford Jct.)	33471	1940		3,429.48		3,429.48	State of Nebraska	6-19-39
Crossing Signals, (Arapahoe)	34428	1950		5,168.56		5,168.56	State of Nebraska	2-13-48
Crossing Signals, (Culbertson)	37753	1950		5,706.72		5,706.72	State of Nebraska	2-14-50
Crossing Signals, (Alma)	33848	1941		2,579.01		2,579.01	State of Nebraska	8-14-50

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 3 Grading	Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Other Locations in Nebraska									
Crossing Signals (Red Cloud)	39238	1939			$ 4,617.77		$ 4,617.77	State of Nebraska	6-14-38
Crossing Signals (Fairmont)	32322	1937			1,438.46		1,438.46	State of Nebraska	12-15-36
Jetties (Orleans)	37236	1949	$5,850.78				5,850.78	State of Nebraska	7-11-49
Crossing Signals (Holdrege)	32682	1940			1,366.06		1,366.06	State of Nebraska	6-14-38
Overhead Viaduct, near Curtis, Br. 75.32	811	1924				$ 3,135.06	3,135.06	State of Nebraska	None
Crossing Signals (Bridgeport)	31941	1937			2,566.83		2,566.83	State of Nebraska	11-12-35
Undercrossing near Sidney	30703	1933		$ 6,780.00			6,780.00	State of Nebraska	12-19-32
Crossing Signals (Minatare)	37468	1949			3,961.26		3,961.26	State of Nebraska	6-9-48
Crossing Signals (Scottsbluff)	37387	1951			13,532.26		13,532.26	State of Nebraska	9-27-50
Undercrossing near Dunning, Br. 214.88	31824	1936		6,580.28			6,580.28	State of Nebraska	2-8-36
Crossing Signals (Broken Bow)	32328	1937			1,720.39		1,720.39	State of Nebraska	12-15-36
Crossing Signals (Sweetwater)	32323	1937			2,020.31		2,020.31	State of Nebraska	12-15-36
Undercrossing near Alliance, Br. 366.17	31824	1936		31,373.34			31,373.34	State of Nebraska	2-8-36
Crossing Signals (Hemingford)	32320	1937			1,307.20		1,307.20	State of Nebraska	12-15-36
Crossing Signals (Hemingford)	37493	1949			6,135.83		6,135.83	State of Nebraska	6-9-49
Crossing Signals (Mullen)	37459	1949			2,959.98		2,959.98	State of Nebraska	6-9-48
Crossing Signals (Wilber)	32881	1939			2,074.92		2,074.92	State of Nebraska	6-14-38
Crossing Signals (Crete)	37256	1949			3,391.74		3,391.74	State of Nebraska	2-4-48
Crossing Signals (Thredord)	37756	1951			4,489.85		4,489.85	State of Nebraska	2-13-48
Crossing Signals (Sidney)	38511	1952			6,463.40		6,463.40	State of Nebraska	4-9-51
Crossing Signals (Chester)	39051	1954			5,073.60		5,073.60	State of Nebraska	11-17-53
Locations in So. Dakota									
Undercrossing near Custer, Br. 44.95	31823	1937		18,199.40			18,199.40	State of Nebraska	10-31-35
Undercrossing near Oreville, Br. 57.30	31759	1937		8,865.98			8,865.98	State of Nebraska	11-7-35
Crossing Signals, (Pluma)	32598	1938			4,156.60		4,156.00	State of Nebraska	
Locations in Colorado									
Crossing Signals (Otis)	37044	1949			6,488.34		6,488.34	State of Colorado	7-20-46
Crossing Signals (Denver)	33540	1941			2,068.18		2,068.18	State of Colorado	12-26-35
Undercrossing, (Denver), Br. 134	32383	1937		19,328.94			19,328.94	State of Colorado	8-31-37
Undercrossing, (Denver), Br. 539.86	32519	1938		67,598.51	3,001.36		70,599.87	State of Colorado	12-23-37
Undercrossing, (Denver), Br. 536.58	33760	1943		54,028.50			54,028.50	State of Colorado	12-11-40
Crossing Signals (Wiggins)	37757	1950			4,538.84		4,538.84	State of Colorado	12-1-49
Crossing Signals (Sterling)	33385	1937			1,765.63		1,765.63	State of Colorado	9-22-37
Crossing Signals (Sterling)	32740	1940			1,469.74		1,469.74	State of Colorado	9-22-37
Undercrossing, near Brush, Br. 453.66	32943	1938		$ 24,430.26			$ 24,430.26	State of Colorado	4-1-38
Crossing Signals, Denver	32725	1938			$ 1,683.94		1,683.94	State of Colorado	9-22-37
Crossing Signals, Akron	32741	1940			2,867.95		2,867.95	State of Colorado	9-22-37
Crossing Signals, Higgins	33732	1940			2,137.15		2,137.15	State of Colorado	4-2-40
Crossing Signals, Derby	35389	1944			1,327.20		1,327.20	State of Colorado	12-22-43
Crossing Signals, Keenesburg	33539	1940			2,240.42		2,240.42	State of Colorado	12-22-39
Crossing Signals, Ackerman	32739	1940			1,260.96		1,260.96	State of Colorado	9-22-37
Crossing Signals, Wray	38874	1954			8,208.45		8,208.45	State of Colorado	1-12-53

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

Location and Type of Facility	A.F.E.	Date Installed	Primary Investment Accounts: Acct. 3 Grading	Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total	Donor	Date of Agreement
Locations in Wisconsin									
Crossing Signals (Prairie DeChien)	26217	1936			2,826.83		2,826.83	State of Wisconsin	3-9-36
Crossing Signals (LaCrosse)	29095	1938			4,043.89		4,043.89	State of Wisconsin	11-22-37
Crossing Signals (Sullivan)	29920	1939			2,972.41		2,972.41	State of Wisconsin	7-11-39
Crossing Signals (Hager)	29903	1938			2,951.01		2,951.01	State of Wisconsin	11-22-37
Crossing Signals (Hager)	29904	1938			3,728.87		3,728.87	State of Wisconsin	11-22-37
Crossing Signals (Cochrane)	46070	1951			3,500.00		3,500.00	State of Wisconsin	12-22-50
Crossing Signals (Onalaska)	48213	1953			3,368.96		3,368.96	State of Wisconsin	4-9-52
Locations in Wyoming									
Crossing Signals (Torrington)	31735-1	1938			1,699.13		1,699.13	State of Wyoming	9-25-35
Crossing Signals (Torrington)	36703	1948			7,267.86		7,267.86	State of Wyoming	2-4-48
Undercrossing near Thermopolis	32229	1937		$ 2,218.57			2,218.57	State of Wyoming	10-17-36
Undercrossing near (Casper)	33472	1941		43,711.78			43,711.78	State of Wyoming	11-21-39
Undercrossing near (Casper)	10068	1924		36,976.52			36,976.52	State of Wyoming	12-12-23
Undercrossing near (Siddons)	10965	1926		9,657.82			9,657.82	State of Wyoming	8-25-25
Crossing Signals (Denver)	31735-4	1939			1,185.81		1,185.81	State of Wyoming	9-25-35
Crossing Signals (Worland)	31735-5	1939			1,375.15		1,375.15	State of Wyoming	9-25-35
Crossing Signals (Kane)	31735-7	1939			1,274.13		1,274.13	State of Wyoming	9-25-35
Overcrossing near Greybull	15674	1931				$ 5,987.61	5,987.61	State of Wyoming	10-22-25
Crossing Signals (Garland)	32767	1939			1,828.44		1,828.44	State of Wyoming	10-5-37
Crossing Signals (Frannie)	31735-6	1939			1,509.15		1,509.15	State of Wyoming	9-25-35
Overcrossing, Thermopolis, Br. 333.20	12823	1928				8,526.32	8,526.32	State of Wyoming	10-25-25
Crossing Signals (Douglas)	32768	1939			1,955.43		1,955.43	State of Wyoming	10-5-37
Crossing Signals (Ranchester)	31735-2	1939			2,080.44		2,080.44	State of Wyoming	9-25-35
Crossing Signals (New Castle)	31735-3	1939			1,455.73		1,455.73	State of Wyoming	9-25-35
Undercrossing near Wesser, Br. 527.73	31070	1934		17,788.42			17,788.42	State of Wyoming	12-11-33
Undercrossing near Gillette, Br. 598.46	12789	1928		10,845.96			10,845.96	State of Wyoming	11-25-25
			$5,850.78	$1,528,403.54	$548,876.82	$63,009.39	$2,146,140.53		

DONATIONS EXCLUDED FROM ROADWAY DEPRECIATION BASE
(Continued)

RECAPITULATION

Primary Investment Accounts

	Acct. 3 Grading	Acct. 6 Bridges	Acct. 27 Signals	Acct. 39 Public Imprv.	Total
1940 & Prior		1,375,127.72	250,218.14	60,660.27	1,686,006.13
1941		51,226.23	60,373.96		111,600.19
1942			4,125.78		4,125.78
1943		58,932.02	3,494.92		62,426.94
1944			1,327.20		1,327.20
1945					
1946			563.12		563.12
1947			16,863.69		16,863.69
1948			18,615.71		18,615.71
1949	5,850.78		45,016.49		50,867.27
1950		39,669.33	42,253.60		81,922.93
1951		3,448.24	33,568.44		37,016.68
1952			6,463.40	2,349.12	8,812.52
1953			27,526.58		27,526.58
1954			38,465.79		38,465.79
Totals	$5,850.78	$1,528,403.54	$548,876.82	$63,009.39	$2,146,140.53

Office of
Engineer Capital Expenditures
October 22, 1965

[Defendant's Exhibit 3 DP] [Mailed Sep. 20, 1944]

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
547 WEST JACKSON BOULEVARD
CHICAGO, ILLINOIS

Attention: Mr. H. W. Johnson
Vice-President and Comptroller

Gentlemen:

Reference is made to your letter dated February 5, 1943, in which you apply for permission to change from retirement to depreciation accounting with respect to road property.

Permission will be granted to change from retirement to depreciation accounting effective January 1, 1943, with respect to the accounts tabulated below, provided you irrevocably agree:

(1) that a reserve for depreciation shall be computed as of December 31, 1942, on all the depreciable property included in these accounts in accordance with the summary tabulation set forth below;

(2) that the remaining sum to be recovered through depreciation allowances shall be limited to the cost or other basis less the depreciation so accrued;

(3) that neither the change of method nor the amount of depreciation so accrued shall have any effect on taxable net income for any year ending prior to January 1, 1943;

(4) that the depreciation rates agreed to are subject to modification if subsequent experience indicates that revision is necessary in order to spread the cost of the assets over their remaining useful lives; such revision, however, is not to be made retroactive;

(5) that complete depreciation accounting in accordance with all the applicable sections of the Internal Revenue Code and Regulations shall be adopted for those accounts;

(6) that the reserve for depreciation accrued to the date of the change from retirement to depreciation accounting shall reduce accumulated earnings and profits in the determination of invested capital for excess profits tax purposes.

Account No.	Classification	Cost At 12/31/1942	Rate % *	Accrued Depreciation At 12/31/1942
3	Grading	$ 8,017,435.00	1.80	$ 2,475,184.00
5	Tunnels and Subways	474,142.00	2.18	142,992.00
6	Bridges, Trestles, and Culverts	58,462,904.00	1.65	17,398,380.00
13	Fences, Snowsheds, and Signs	3,433,705.00	2.00	1,716,850.00
16	Station and Office Buildings	23,075,079.00	1.77	6,767,509.00
17	Roadway Buildings	1,575,518.00	2.23	517,142.00
18	Water Stations	6,833,375.00	2.15	1,947,242.00
19	Fuel Stations	1,651,649.00	2.50	529,212.00
20	Shops and Enginehouses	12,422,736.00	1.73	3,235,229.00
23	Wharves and Docks	106,378.00	2.48	47,257.00
26	Telegraph and Telephone Lines	4,736,476.00	2.24	1,652,309.00
27	Signals and Interlockers	9,806,614.00	2.89	2,573,610.00
29	Power Plants	759,457.00	1.31	130,491.00
31	Power-Transmission Systems	1,093,235.00	2.10	218,539.00
35	Miscellaneous Structures	1,615,597.00	1.99	380,212.00
37	Roadway Machines	1,475,656.00	5.49	519,157.00
39	Public Improvements-Construction	5,547,747.00	2.07	1,536,545.00
44	Shop Machinery	5,733,849.00	3.10	2,095,370.00
45	Power-Plant Machinery	1,707,368.00	3.01	675,446.00
705	Miscellaneous Physical Property	6,354,225.00	1.78	1,906,268.00
		154,883,145.00		46,464,944.00

* Applicable to gross cost.

It is mutually understood that this is an agreement in principal and that a detailed investigation of the depreciation basis has not been made by the Bureau, and that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should investigation disclose errors of cost or valuation. In the event of any such correction the accrued depreciation at December 31, 1942, shall be appropriately adjusted, but no retroactive adjustment shall be made to depreciation which may have been allowed subsequent to December 31, 1942.

It is further mutually agreed that the road assets listed below, which have been retired in 1943, or are to be retired in 1944, have not been included in the basis for depreciation, and that retirement losses are to be allowed on the abandonment of these assets. In the determination of these losses, however, the amounts stated shall be reduced by the depreciation sustained prior to March 1, 1913.

MAJOR ASSETS RETIRED OR TO BE RETIRED IN YEAR DESIGNATED AND PROVIDED FROM THE DEPRECIATION BASIS

Account No.	Classification	Year 1943	Year 1944
3	Grading	$ 2,583.00	$ 1,435.00
6	Bridges, Trestles, and Culverts	71,201.00	208,698.00
13	Fences, Snowsheds, and Signs	4,863.00	19,756.00
16	Station and Office Buildings	177,505.00	108,398.00
17	Roadway Buildings	4,064.00	4,564.00
18	Water Stations	50,611.00	67,909.00
19	Fuel Stations	23,794.00	66,291.00
20	Shops and Enginehouses	125,340.00	161,853.00
26	Telegraph and Telephone Lines	4,505.00	25,001.00
27	Signals and Interlockers	261,135.00	429,869.00
29	Power Plants	10,238.00	1,508.00
31	Power-Transmission Systems	8,573.00	15,441.00
35	Miscellaneous Structures	1,500.00	1,797.00
39	Public Improvements-Construction	2,739.00	13,996.00
44	Shop Machinery	70,435.00	106,878.00
45	Power-Plant Machinery	8,940.00	14,651.00
		831,026.00	1,248,045.00

Permission to change from retirement to depreciation accounting as of January 1, 1943, will become effective upon receipt of a letter agreeing to all the terms and conditions set forth herein, signed with the corporate name and pen signature of the president, vice-president, or other principal officer, over his official title. It is requested that your acceptance letter be submitted in duplicate.

Very truly yours,
(Signed) HAROLD N. GRAVES
Acting Commissioner

[Filed, Apr. 29, 1969, Court of Claims]

[Defendant's Exhibit 4 DP] [Dated April 20, 1945]

547 WEST JACKSON BOULEVARD
CHICAGO 6, ILLINOIS

Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue,
Washington 25, D. C.

Dear Sir:

Referring to your letter, dated September 20, 1944, File ITILV:PU-HSR, granting permission to the Chicago, Burlington & Quincy Railroad Company to change from retirement to depreciation accounting with respect to road and miscellaneous physical property, as therein specified, effective January 1, 1943, under certain specified conditions:

The Chicago, Burlington & Quincy Railroad Company accepts the terms and conditions set forth in said letter of September 20, 1944, upon the understanding and in the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise, the fact that the Chicago, Burlington & Quincy Railroad Company has accepted the terms and conditions set forth in said letter shall not preclude it from the benefits of any such changes in said terms or conditions as are applicable to railroads in general, but the Chicago, Burlington & Quincy Railroad Company shall in any event be entitled to the benefit of any such changes regardless of the acceptance herein contained.

Yours truly,
CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

By Ralph Budd
President.

[Filed, Apr. 29, 1969, Court of Claims]

[Defendant's Exhibit 5 DP] [Mailed April 12, 1943]

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
547 WEST JACKSON BOULEVARD,
CHICAGO, ILLINOIS.

Attention: Mr. H. W. Johnson,
Vice-President and
Comptroller.

Sirs:

Reference is made to office letter of February 10, 1943 and to your letter of February 5, 1943, applying for permission to change from retirement to depreciation accounting for road property.

It now appears that it will be impossible to arrange a conference, at any time in the near future, for a discussion of the problems involved. Accordingly, there is enclosed a mimeograph which states the terms under which permission will be granted and describes the information that should be furnished.

This information should be prepared and submitted as soon as possible.

Enclosure:
Mimeograph.

Respectfully,
TIMOTHY C. MOONEY,
Deputy Commissioner,

By R. C. STAEBNER
R. C. STAEBNER,
Chief of Section.

[Filed, Apr. 29, 1969, Court of Claims]

[Defendant's Exhibit 6 DP] [Filed Apr. 29, 1969]

MIMEO 58

CHANGE FROM RETIREMENT TO DEPRECIATION ACCOUNTING FOR ROAD PROPERTY

In changing from retirement to depreciation accounting, each railroad is required to irrevocably agree:

(1) That a reserve for accrued depreciation in accordance with one of the options set forth below shall be set up as of the date the change in accounting method is effective.

(2) That the remaining sum to be recovered through depreciation allowances shall be limited to the cost or other basis less the depreciation so accrued.

(3) That neither the change of method nor the amount of depreciation so accrued shall have any effect on taxable net income for any year ending prior to the date of change in accounting method.

(4) That the depreciation rates agreed to are subject to modification if subsequent experience indicates that revision is necessary in order to spread the cost of the assets over their remaining useful lives, such revision however, not to be made retroactive.

(5) That complete depreciation accounting in accordance with all of the applicable sections of the Internal Revenue Code and Regulations shall be adopted for those accounts which are changed from retirement to depreciation accounting.

(6) (See page 4)

In connection with condition (1) above, it is necessary to select the option and agree upon the specific reserve for each account to be depreciated before permission is granted.

Each railroad may elect to determine its reserve by one of the following methods:

1. The accounts may be reconstructed from their beginning, or may start with the I. C. C. valuation, setting up as a reserve the difference between cost of reproduction new and cost of reproduction less accrued depreciation as determined at the valuation date. From either starting point the capital accounts shall be carried forward, increased by additions and decreased by retirements, except that any increase in replacement costs or additions or betterments expensed which have been deducted for income tax purposes

may not be restored. Depreciation at rates to be agreed upon shall be computed for all years and accrued into a depreciation reserve. From this reserve shall be deducted the cost of normal retirements, but for retirements due to casualty or special obsolescence, which would have been allowable under depreciation accounting, only the accrued depreciation thereon shall be deducted.

2. A reserve may be set up by multiplying the expired life of individual structures or the weighted average ages of the accounts representing groups of assets now in service by the depreciation rates agreed upon for these assets.

3. A reserve of 30% of the total depreciable road accounts at December 31, 1942, may be set up. It is to be understood that this is an overall reserve and the total amount so computed is to be allocated to the different depreciable accounts on a reasonable basis, such allocation to be a matter of agreement between each railroad and the Bureau.

The basis for depreciation shall be the cost of the existing depreciable property to the present taxpayer, determined in accordance with sections 113 and 114(a) of the Internal Revenue Code. Property acquired prior to the date of valuation by the Interstate Commerce Commission may be set up on the basis of such valuation in lieu of a valuation at March 1, 1913, except that the basis of property not constructed by the present owner but acquired by purchase subsequent to March 1, 1913, may not exceed the actual cost thereof to the present owner. Reorganized railroads entitled to the basis of the predecessor company under section 142(b)(20) of the Revenue Act of 1942 shall determine the predecessor's basis in the same way.

Replacement costs and additions and betterments which have been deducted for income tax purposes in prior years may not be restored to the capital account. Estimated overheads must be excluded, and only actual expenditures reasonably attributable to depreciable property may be included. This rule is applicable to the following expenditures during construction—

Engineering
General officers and clerks
Law
Stationery and printing
Other expenditures, general.

The amounts of such expenditures should be shown separately. Interest and taxes may not be included in the depreciation basis.

The basis may include only the investment in property which is actually depreciable. Thus excavations, dredging, expendable small tools, land improvements, land surveys, etc., are not depreciable expenditures, whereas retaining walls, drainage systems, etc., are. Donated property or contributions or grants in aid of construction from any source must be excluded.

Exhibit "A" shows a suggested breakdown of the primary accounts for the purpose of determining depreciation rates and expired lives and reserves. This grouping need not be rigidly followed if other groupings are more convenient. However, a logical breakdown for determining useful lives should be prepared.

In view of the fact that it will be impossible for the Bureau to make a detailed investigation of the depreciation basis, the permission letter includes a mutual understanding that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should subsequent investigation disclose errors of cost or valuation. In the event of such correction the accrued depreciation would be appropriately adjusted, but no retroactive adjustment will be made for the depreciation which may have been allowed subsequent to the date of the change in accounting method.

Depreciation will ordinarily be computed by primary accounts on the basis of a composite overall depreciation rate determined from a consideration of the principal structural elements and important separate structures within the account. A single reserve will be set up for each primary account, and all normal retirements charged against this reserve. If a taxpayer desires to maintain sub-accounts with separate reserves on the basis of the groupings used in determining the component rates and expired lives from which the primary account rate and starting reserve is computed, it may do so. However, the overall composite rate and depreciation reserve by primary accounts will be controlling for income tax purposes, and this rate will be subject to revision whenever there is a substantial change in the type of structures or equipment included within the account, or subsequent experience indicates a revision is necessary in order to spread the cost of the assets over their remaining useful lives.

The taxpayer should proceed to prepare a statement of the basis for depreciation at the date of changeover, in accordance with the above instructions. The normal useful lives, expired lives and estimated net salvage should be stated for each of the groups within the accounts. Careful consideration should be given to the determination of normal useful lives, which must be reasonable in the light of past experience and future prospects.

In the determination of expired lives or weighted average ages of accounts for the purpose of allocating the 30% reserve under Option 3, above, extreme refinement is unnecessary. Ordinarily the age of 90% of the investment in the account, determined with reasonable accuracy, is sufficient for this purpose. If Option 2 is elected, much greater accuracy in the determination of the age of an account is required.

A schedule by primary accounts broken down into groups along the lines suggested above should be prepared, (see attached "Depreciation Study of Road Accounts"), showing for each group the investment, estimated net salvage, the expired life (or weighted average age), and the taxpayer's estimate of the average normal useful life. These schedules should be submitted in duplicate to the Commissioner of Internal Revenue, marked with the symbols IT:EV:PU. After receipt and consideration by the Bureau the taxpayer will be informed by letter of the position of this office with respect to the useful lives and salvage values claimed and the further steps necessary to the completion of the depreciation schedules, or a conference will be arranged for the discussion of these questions.

If depreciation is claimed on any property under lease, whether as lessor or lessee, and regardless of whether or not the other party to the lease is owned or controlled by the applicant railroad, complete copies of the leases covering such property should be filed.

The following clause has been added to the terms set forth on the first page to which irrevocable agreement is required:

(6) That the reserve for depreciation accrued to the date of the change from retirement to depreciation accounting shall reduce accumulated earnings and profits in the determination of invested capital for excess profits tax purposes.

Tentative Road Asset Groupings for Railroads

Account 2½—Other R/W Expenditures
- Masonry (See Acct. 3)
- Steel (See superstructures, Acct. 6)
- Pipe (See drainage, Acct. 3)
- Paving (See Acct. 16)

Account 3—Grading
- Rock-filled timber cribs
- Rip-rap, large stone
- Rip-rap, small stone
- Slag and Cinder Mats
- Retaining Walls and Foundations:
  - Stone Masonry
  - Plain Concrete
  - Reinforced Concrete
  - Brick
  - Rubble, In Mortar
  - Rubble, Dry
- Piling:
  - Steel
  - Concrete
  - Treated Timber
  - Untreated Timber
- Drainage:
  - Cast Iron Pipe
  - Concrete Pipe
  - Corrugated Iron Pipe
  - Vitrified Clay Pipe
  - Wood Box

Account 5—Tunnels and Subways
- Tunnel Lining & Portals:
  - Stone Masonry
  - Plain Concrete
  - Gunite Concrete
  - Reinf. Concrete
  - Brick
  - Treated Timber
  - Untreated Timber
- Ventilation system
- Drainage (See Acct. 3)

Account 6—Bridges, Trestles & Culverts
- (Large structures should be segregated)
- Substructures (See Retaining Walls Acct. 3)
- Superstructures:
  - Girders
  - I-Beams
  - Trusses
  - Draw Bridges
  - Concrete Slabs

Account 6—Continued
- Trestles:
  - Steel
  - Concrete
  - Treated Timber
  - Untreated Timber
- Arches (See Retaining Walls, Acct. 3)
- Culverts (See Drainage, Acct. 3)
- Signs:
  - Wood
  - Metal
  - Concrete

Account 7—Elevated Structures
- Substructures (See Retaining Walls, Acct. 3)
- Superstructures (See Acct. 6)

Account 13—Fences, Snowsheds and Signs
- Fences (Separate by kind)
- Snowsheds:
  - Timber
  - Other
- Signs (See Acct. 6)

Account 16—Station and Office Buildings
- (Large buildings should be segregated)
- Buildings:
  - Stone Masonry
  - Brick and Concrete
  - Terra Cotta
  - Large Frame
  - Small Frame
  - Corrugated Iron
  - Steel
  - Frame Sheds
  - Carbodies
- Retaining Walls (See Acct. 3)
- Train Sheds (Describe)
- Canopies
- Platforms:
  - Concrete
  - Asphalt
  - Wood
- Ice Houses (See Buildings Acct. 16)
- Stock Pens
- Subways (See Retaining Walls, Acct. 3)
- Trestles (See Acct. 6)

Account 16—Continued
- Coal Pockets (See Trestles, Acct. 6)
- Elevated Tanks (See Acct. 18)
- Fuel Tanks:
  - Underground
  - On Piers
- Pipe Lines (See Acct. 20)
- Scales:
  - Track
  - Wagon
  - Platform
- Paving and Surfacing:
  - Concrete
  - Brick
  - Asphalt
  - Wood Block
  - Macadam
  - Gravel
  - Cinders
- Cranes and Derricks (State Kind)
- Machinery
- Furniture and Fixtures
- Miscellaneous

Account 17—Roadway Buildings
(See Account 16)

Account 18—Water Stations
- Wood Tank:
  - on Stone or Concrete
  - on Steel Tower
  - on Wood Tower
- Steel Tank:
  - on Stone or Concrete
  - on Steel Tower
  - on Wood Tower
- Water Treating Equipment
- Machinery
- Buildings (See Acct. 16)
- Wells, Dams, and Reservoirs
- Water Columns
- Pipe Lines (See Acct. 20)

Account 19—Fuel Stations
- Trestle Type:
  - Steel
  - Concrete
  - Treated Timber
  - Untreated Timber
- Mechanical Type:
  - Steel
  - Concrete
  - Treated Timber
  - Untreated Timber
- Machinery

Account 19—Continued
- Coal Bins, Timber
- Coaling Platforms
- Fuel Oil Tanks:
  - Large
  - Small

Account 20—Shops and Enginehouses
- Buildings (See Acct. 16)
- Scales (See Acct. 16)
- Pits:
  - Concrete
  - Brick
  - Timber
- Pipe Lines:
  - Cast Iron
  - Wrought Iron
  - Galvanized
  - Black
  - Steel
- Turntables
- Transfer Tables
- Platforms (See Acct. 16)
- Mechanical Equipment
- Paving (See Acct. 16)
- Furniture
- Miscellaneous

Account 21—Grain Elevators
- Buildings (See Acct. 16)
- Mechanical Equipment
- Electrical Equipment
- Paving (See Acct. 16)

Account 22—Storage Warehouses
- Buildings (See Acct. 16)
- Machinery
- Paving (See Acct. 16)

Account 23—Wharves and Docks
- Bulkheads:
  - Steel
  - Stone
  - Concrete
  - Treated Timber
  - Untreated Timber
- Cribbing, Rock-fill
- Piers:
  - Steel
  - Stone
  - Concrete
  - Treated Timber
  - Untreated Timber
- Docks:
  - Concrete on Wood Piles
  - Steel

Account 23—Continued

Docks—Continued
Treated Timber
Untreated Timber
Transfer Bridges:
Steel
Treated Timber
Untreated Timber
Ferry Racks and Slips
Pipe Lines (See Acct. 20)
Beacons
Machinery
Miscellaneous

Account 24—Coal and Ore Wharves

Buildings (See Acct. 16)
Other Items (See Acct. 23)

Account 26—Tel. and Tel. Lines

Pole Lines:
Concrete
Steel
Treated
Butt Treated
Untreated
Wire:
Copper
Iron
Other
Cable:
Aerial
Underground
Submarine
Conduits:
Vitreous Clay in Concrete
Metal or Fibre in Concrete
Wood, Fibre, etc. in Earth
Manholes
Office Equipment
Miscellaneous

Account 27—Signals and Interlockers

Buildings (See Acct. 16)
Interlockers:
Mechanical
Electro-pneumatic
Pneumatic
Electric
Automatic Signals
Centralized Train Control
Automatic Block & Colored Light Systems
Train Order Signals
Battery Wells and Houses

Account 27—Continued

Signal Bridges
Crossing Gates
Crossing Signals
Annunciators
Car-retarders
Poles (See Acct. 26)
Wire (See Acct. 26)
Ducts
Miscellaneous

Account 29—Power Plants

Buildings (See Acct. 16)
Stacks:
Brick
Steel
Concrete
Coal Trestles (See Trestles Acct. 6)
Pipe Lines (See Acct. 20)
Pits (Kind)
Power Dams and Canals
Miscellaneous

Account 31—Power Transmission systems

Pipe Lines (See Acct. 20)
Pole Lines (See Acct. 26)
Wire (See Acct. 26)
Cable (See Acct. 26)
Conduits (See Acct. 26)
Manholes
Transformers
Third Rail
Towers, Steel
Miscellaneous

Account 36—Miscellaneous Structures

Buildings (See Acct. 16)
Trestles (See Acct. 6)
Flood Lights
Other Items (See Acct. 16)

Account 37—Roadway Machines

Cars:
Hand
Push
Motor
Speeders
Crane
Concrete Mixers
Ditchers
Pile Drivers
Rail Layers
Weed Burners
Sprayers
Auto Inspection Cars

Account 39—Public Improv's. Const.

Overhead Bridges:

Masonry (See Acct. 3)

Steel (See Acct. 6)

Pipe (See Acct. 20)

Timber (See Acct. 6)

Lighting

Account 39—Continued

Paving (See Acct. 16)

Account 44—Shop Machinery

(To be grouped by assets having similar service lives)

Account 45—Power Plant Machinery

(See Acct. 44)

THE EAST & WEST RAILWAY COMPANY
DEPRECIATION STUDY OF ROAD ACCOUNTS

(1) Asset	(2) Cost at Dec. 31, 1942	(3) Net Salvage Value %	(4) Service Value at Dec. 31, 1942	(5) Expired Life Years	(6) Total Service Life, Years	(7) Amount of Annual Depreciation	(8) Depreciation Rate %	(9) Expired Dollar Years	(10) Past Depreciation to Dec. 31, 1942
Account No. 3—Grading									
Excavation ($1,000,000)	—	—	—	—	—	—	—	—	—
Retaining Walls, Coursed Masonry	$100,000	—	$100,000	36	100	$1,000.00	1.00	$ 36,000.00	$ 23,961.86
Retaining Walls, Dry Rubble	50,000	—	50,000	34	90	555.56	1.11	18,889.04	12,572.68
Road Drainage, C. I. Pipe	90,000	—	90,000	40*	80	1,125.00	1.25	45,000.00	29,952.33
Road Drainage, Vit. Pipe	60,000	—	60,000	25	50	1,200.00	2.00	30,000.00	19,968.22
Piling, Untreated	20,000	—	20,000	20	40	500.00	2.50	10,000.00	6,656.08
Totals—Account No. 3	$320,000		$320,000			$4,380.56	1.37	$139,889.04	$ 93,111.17
Account No. 5—Tunnels and Subways									
Excavation ($500,000)	—	—	—	—	—	—	—	—	—
Tunnel Lining, Stone Masonry	$ 80,000	—	$ 80,000	38	100	$ 800.00	1.00	$ 30,400.00	$ 20,234.46
Tunnel Lining, Treated Timber	18,000	—	18,000	22	40	450.00	2.50	9,900.00	6,589.51
Drainage, C. I. Pipe	3,000	—	3,000	36	80	37.50	1.25	1,350.00	898.57
Totals—Account No. 5	$101,000		$101,000			$1,287.50	1.27	$ 41,650.00	$ 27,722.54
Account No. 18—Water Stations									
Pump Houses, Brick	$ 16,000	—	$ 16,000	36	80	$ 200.00	1.25	$ 7,200.00	$ 4,792.37
Pump Houses, Frame	4,000	—	4,000	22	50	80.00	2.00	1,760.00	1,171.47
Pump Houses, Frame, Adds. & Betts.	1,000	—	1,000	2(a)	30(a)	33.33	3.33	66.67	44.38
Tanks, Wood Tub, Untreated Frame Tower	8,000	—	8,000	21	30	266.67	3.33	5,600.07	3,727.45
Tanks, Steel Tub, Steel Tower	10,000	2.0	9,800	31	55	178.18	1.78	5,523.58	3,676.53
Stand Pipes	5,000	2.0	4,900	20	35	140.00	2.80	2,800.00	1,863.70

C. I. Pipe Lines	7,000	—	7,000	20	50	140.00	2.00	2,800.00	1,863.70
Pumping Equipment	12,000	2.0	11,760	22	33⅓	352.80	2.94	7,761.60	5,166.18
Totals—Account No. 18	$ 63,000		$ 62,460			$1,390.98	2.21	$ 33,511.92	$ 22,305.78
Account No. 26—Telegraph and Telephone Lines									
Pole Lines, Untreated Poles	$ 15,000	—	$ 15,000	20	30	$ 500.00	3.33	$ 10,000.00	$ 6,656.07
Aerial Wire, Iron Wire	3,500	—	3,500	30	50	70.00	2.00	2,100.00	1,397.77
Aerial Wire, Copper Wire	9,000	15.0	7,650	30	85	90.00	1.00	2,700.00	1,797.14
Aerial Cable, Insulated	700	10.0	630	18	32	19.69	2.81	354.42	235.90
Underground Conduit, Iron Pipe	100	—	100	28	48	2.08	2.08	58.24	38.77
Underground Cable	500	10.0	450	28	40	11.25	2.25	315.00	209.67
Office Equipment	3,000	1.0	2,970	16	25	118.80	3.96	1,900.80	1,265.19
Totals—Account No. 26	$ 31,800		$ 30,300			$ 811.82	2.55	$ 17,428.46	$ 11,600.51
Totals All Accounts	$515,800		$513,760			$7,870.86	1.53	$232,479.42	$154,740.00

Legend

Col. 2 = I.C.C. Cost of Reproduction New plus or minus the net amount of additions, betterments and retirements subsequent to valuation date.
Col. 3 = Estimated net salvage percent subject to agreement.
Col. 4 = Col. 2 times 100% minus Col. 3.
Col. 5 = Computed as shown at the right.
Col. 6 = Estimated Service Life subject to agreement.
Col. 7 = Col. 4 ÷ Col. 6.
Col. 8 = Col. 7 ÷ Col. 2.
Col. 9 = Col. 7 times Col. 5.
Col. 10 =

$$\frac{\text{Total of all Accounts, Col. 2 times 30\%}}{\text{Total of all Accounts, Col. 9}} \times \text{Amounts in Col. 9.}$$

*Computation of Expired Life:

Cost	Expired Life	Dollar Years
$10,000.00	46 Yrs.	$ 460,000.00
50,000.00	40 Yrs.	2,000,000.00
30,000.00	38 Yrs.	1,140,000.00
$90,000.00		$3,600,000.00

$$\frac{3{,}600{,}000.00}{90{,}000.00} = 40 \text{ Years}$$

(a) Additions and Betterments

Addition to frame pump house consisted of expenditure for enlargement of existing structure 20 years later and will be retired coincident with original pump house.

NOTE: Used assets acquired should be designated as second-hand (SH) and year of construction shown with item designation. Years owned by taxpayer should be shown in Col. 5 and estimated remaining life in Col. 6.

[Filed Apr. 29, 1969, Court of Claims]

[Defendant's Exhibit 7 DP]

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
CHICAGO, ILLINOIS
DECEMBER 14, 1959

District Director
Internal Revenue Service
22 West Madison Street
Chicago, Illinois

Dear Sir:

Chicago, Burlington & Quincy Railroad Company hereby irrevocably elects to have Section 94 of the Technical Amendments Act of 1958, also known as the Retirement-Straight Line Adjustment Act of 1958, apply to the determination of its Federal tax liability for all applicable years.

This election is filed in accordance with the requirements of regulation Section 1.9001-1(b)(3).

Yours very truly,
CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
By /s/ [Illegible]
By /s/ Eldon Martin
Vice President

Attest
/s/ [Illegible]
Secretary

[Filed, Apr. 29, 1969, Court of Claims]

[Defendant's Exhibit 8 DP] [Dated Jul. 26, 1961]

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
547 WEST JACKSON BOULEVARD
CHICAGO 6, ILLINOIS

Attention: Mr. R. C. Smith
Comptroller

Terms Letter Date:
Sept. 20, 1944

Gentlemen:

This refers to your letter of May 1, 1961, relative to the application of Section 94 of the Technical Amendments Act of 1958, submitting revised schedules for your depreciable roadway property.

You were granted permission to change your method of accounting from the retirement to straight-line depreciation method for specified Roadway Accounts in "terms letter" referred to above.

The revised schedules show your depreciable bases, revised depreciation rates based on estimated remaining lives, gross salvage, and revised accrued depreciation reserves as determined in accordance with the provisions of section 94 of the Technical Amendments Act of 1958. Since your unrecovered cost was determined by using gross salvage, dismantling cost applicable to the retirement of depreciable road property is a proper charge to operating expenses.

Based on the information furnished in the letter and schedules referred to in paragraph one above, the depreciation rates, bases, and reserves for depreciation as shown in the attached schedule are acceptable to this office, effective January 1, 1956, provided a timely election has been made under section 94.

It is mutually understood that complete depreciation accounting in accordance with all of the applicable sections of the Internal Revenue Code and Regulations will be followed and, where necessary, proper accounting adjustments shall be made to adjust for the use of betterment accounting in prior and subsequent years.

It is also understood that a detailed investigation of the depreciable basis has not been made by the Service, and that the basis may be corrected to conform to the allowable

basis under the Internal Revenue Code, should investigation disclose any errors. It cannot be determined from these schedules if the adjustments for 3/1/13 depreciation reserve on retirements from 12/31/24 to change-over date are as allowed for these years or are estimated figures. The 1/1/56 adjustment to the reserve should reflect the 3/1/13 reserve on retirements from 12/31/24 to changeover date as allowed in those years for computing taxable income. In the event of any correction the accrued depreciation reserve at December 31, 1955, shall be appropriately adjusted for depreciation sustained before March 1, 1913.

The tabulation shown on Form M-3566, attached, includes remaining "terms letter" property plus net straight line additions added between your change-over date and January 1, 1956. The remaining life rates on Form M-3566 apply only to this property and any minor additions to such property, and may be changed if future experience indicates the need for revision. Property acquired after December 31, 1955, will be depreciated at rates based on estimated average useful lives.

A copy of this letter should be attached to your 1956 amended income tax return or claim for refund, and a copy is enclosed for that purpose.

This letter is not to be construed as an agreement within the meaning of section 167(d) of the Internal Revenue Code of 1954.

Very truly yours,
(signed) Ned W. Arick

Director,
Special Technical Services Division

[Filed, Apr. 29, 1969, Court of Claims]

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

Item	Basis at 1/1/56	Rate % *	Accrued Dep. Reserve at 1/1/56
2½. Other right-of-way expenditures	$ 136,347	2.50	$ 17,359
3. Grading	10,082,477	2.65	3,210,611
5. Tunnels and subways	475,612	3.67	86,106
6. Bridges, Trestles and culverts	66,987,553	2.66	16,760,348
13. Fences, snowsheds and signs	3,617,251	2.44	1,853,868
16. Station and office buildings	30,956,906	3.99	6,438,078
17. Roadway buildings	1,633,426	3.33	400,510
18. Water stations	2,300,712	4.67	195,927
19. Fuel stations	872,432	3.08	130,378
20. Shops and enginehouses	13,151,091	2.55	3,122,458
21. Grain elevators			
22. Storage warehouses			
23. Wharves and docks	89,683	2.64	32,487
24. Coal and ore wharves			
26. Communication systems	6,383,612	3.47	2,365,670
27. Signals and interlockers	19,283,720	4.03	3,701,557
29. Power plants	634,684	1.75	123,600
31. Power-transmission systems	1,275,700	2.76	258,006
35. Miscellaneous structures	2,067,239	2.93	463,423
37. Roadway machines	4,934,981	7.52	1,496,997
39. Public improvements-construction	6,367,268	3.13	1,626,201
44. Shop machinery	6,363,436	4.43	2,303,480
45. Power-plant machinery	1,834,857	4.21	592,414
737. Miscellaneous physical property *	4,170,767	8.68	965,700

* Remaining Terms Letter property only. Does not include 1943-1955 Additions.

TRANSCRIPT OF PROCEEDINGS

[Washington, D.C., March 11, 1969]

* * * *

[70] not serving as agreement.

COMMISSIONER DAVIS: I assume that, on an opening statement. Before you start, I want to ask you something about the issues.

If I remember, from the last trial session we had—is it agreed or is it contested, one or the other, that the railroads took title to the various properties involved? Is that a problem in the case or not?

MR. LANGER: I don't believe it is a problem. I believe the contracts themselves which are in evidence, show where the title lies. I believe the witness today will state that generally the title to overpasses and underpasses was with the railroad, but title to the red lights and such was with the state.

COMMISSIONER DAVIS: But that is all a matter of record in the contracts involved. Is that correct?

MR. LANGER: I believe so.

MR. O'ROURKE: If I may make a statement, Your Honor, I believe that the record will show that the title to the underpasses and overpasses passed to the railroad and the title to the protective facilities which could be either lights, arms or both, also went to the railroads, with the maintenance of the protective facilities to be the responsibility of the [71] railroads.

COMMISSIONER DAVIS: Well, the record will show what it will show, in that regard. I wanted to have that clear in my mind, before you start. You may proceed.

WHEREUPON——

MERRILL D. KNIGHT,

a witness produced on behalf of the Defendant, having been first duly sworn by said Commissioner, was examined, and in answer to interrogatories testified as follows:

DIRECT EXAMINATION

By MR. LANGER:

Q. Would you please state your full name and address?

A. Merrill D. Knight, Jr., 617 Poplar Drive, Falls Church, Virginia.

Q. Are you presently retired?

A. I am.

Q. When did you retire?

A. In April of 1968.

Q. 1968?

A. Yes.

Q. What was your occupation, prior to your retirement?

A. Highway Engineer.

Q. Approximately how long were you engaged in that [72] occupation?

A. I was engaged by the Bureau of Public Roads from 1945 until 1968.

Q. Focusing now back to the period of 1945, did you say?

A. Yes, 1945.

Q. Well, going from 1945 and going forward to 1968, would you please tell us the various positions that you held at the Bureau of Public Roads, and exactly what your duties were, with respect to those positions?

A. In 1945 to 1948, I examined various city plans and the improvement for highways including railway grade crossings.

In 1948 to 1958, I examined the program submitted by the State Highway Department, including projects for construction of various types of highway facilities, including railway-highway projects.

From 1958 to 1961, I was concerned with overall traffic planning and street lay out.

From 1961 to 1968, I was concerned principally with the administration of the Federal Aid Highway Act, with respect to railway-highway crossings.

Q. I believe you mentioned rail-highway projects a few moments ago. Would you please explain what that means?

[73] A. Railway-highway project is a project for the construction or protection at rail-highway crossings. In order to facilitate the movement of traffic and for the safety of the public.

Q. Now before we go any further with that, would you please tell us about your professional education and any professional degrees that you have?

A. I received my Bachelor of Science Degree from Washington College at Chestertown, Maryland, in 1919, and immediately began work with the Delaware State Highway Department and later the North Carolina Highway Department, and in 1924, with the City of Lynchburg.

From 1925 to 1935, I was Director of Public Works for the City of Lynchburg.

In 1927, I qualified before the State Board of Examiners of North Carolina as a professional engineer. I am presently, and have been registered in the State of Virginia as a professional engineer, since 1938.

During the depression, I worked for the Works Project Administration and later on for the War Production Board, transferring from the War Production Board to the Bureau of Public Roads in 1945.

Q. During the time that you were a Director of Public [74] Roads in Lynchburg, Virginia, did you have any connection—first of all, could you tell us approximately when that was again—the Director of Public Roads of Lynchburg, Virginia.

COMMISSIONER DAVIS: Public Works.

THE WITNESS: Public Works.

By MR. LANGER:

Q. I am sorry. When was that?

A. That was from 1925 to 1935.

Q. During that time, did you have anything to do with railway-highway projects?

A. I did. We had one street widening project that required the widening of an underpass under the Southern Railroad. The Southern Railroad was instructed by the City Council of Lynchburg to reconstruct this underpass, and did so, and my connection with it, with that work, was the review and approval of the plans submitted by the railroad, and the correspondence concerning its financing. That was the extent, as Director of Public Works.

Q. Well, could you tell us whether, in handling those projects that you just mentioned, you had occasion to become familiar with the methods by which the Federal Statutes were administered, with respect to providing funds for these items.

Mr. O'Rourke: Excuse me. When you say "these [75] items," you mean the items that the witness has just identified?

Mr. Langer: I am sorry.

Mr. O'Rourke: And does it apply to the Southern Railway Company?

Mr. Langer: In fact, I would rather retract that question and ask it in a different way, if Your Honor please.

The Witness: Federal funds were not involved in the construction of the Southern Railway project. That was done by the railway company.

By Mr. Langer:

Q. Did you have occasion to become familiar with the purposes of railway-highway project construction, at that time?

A. Yes, the purpose of that particular project was to widen the pavement and provide for a greater number of vehicles to pass under.

Q. While you were at the Bureau of Public Roads, did you have occasion to become knowledgeable and familiar with respect to railway-highway projects?

A. Yes, and prior to my connection with the Bureau of Public Roads, while I was with the Works Project Administration, Federal funds were used in the construction of an overpass over the Norfolk and Western Railroad in Lynchburg.

Mr. O'Rourke: If Your Honor please, I will concede [76] that the witness is competent to testify as to the construction and purpose of overpasses and underpasses and protective facilities, if we are endeavoring to qualify him as an engineer with knowledge in that area.

I am not sure of the purpose of the question.

Commissioner Davis: I am not either. I think you have got something more than that in mind. Go ahead.

By Mr. Langer:

Q. I would now like to ask the witness if, to his knowledge, the Bureau of Public Roads ever issued any specific official memorandum that dealt with classification of railway-highway projects.

A. Yes, they did, in General Administrative Memorandum 325 and 298.

Q. Have you brought copies of those with you?

A. We have copies here, properly certified.

(Memorandum dated August 26, 1948 General Administrative Memorandum 325 was marked for identification Defendant's Exhibit No. 1-DP.)

(General Administrative Memorandum 298, dated March 19, 1946 was marked for identification Defendant's Exhibit No. 2-DP.)

[77]

By Mr. Langer:

Q. Would you please direct your attention to GAM No. 325 which has been described as Defendant's Exhibit No. 1-DP and would you please describe that document for us.

A. This memorandum applies to projects for the elimination of hazards at railway-highway crossings.

Q. Would you please turn to Defendant's Exhibit No. 2-DP which is the other memorandum, and would you please describe that one for us?

A. The other memorandum had the same purpose, but did not provide a classification of projects, and was therefore superseded by 325.

Q. In other words, just for clarification, the document, Defendant's Exhibit No. 2-DP for identification was superseded by Document No. 1?

A. That is right.

Q. Now would you please tell us how this classification was done, first in the earlier memorandum, and then in the second memorandum? In other words, I would ask you first to look at Document No. 2 and then go back to No. 1.

A. Both memoranda were issued to carry out the purposes of the Federal Aid to Highways Act of 1944, which provides that the railroads would contribute an amount equal to the [78] benefits received from the construction, not to exceed ten per cent.

The earlier document set out several features of these projects which would be taken into consideration, in deter-

mining the benefits, but due to the fact that these benefits were often intangible and seldom subject to the same interpretation by the various parties, the later document classified the railroads according to their elements such as grade crossing elimination, the reconstruction of existing highways and railroad separation, and the installation of protective devices.

It sets forth in detail which one of these classes would be considered of cognizable benefits and which ones would not. Those that were considered of cognizable benefit, would call for a contribution of ten per cent of the costs from the railroads. Those that were not would be constructed without any cost to the railroad whatsoever.

Q. Now you mentioned that the statute required the railroads to pay up to ten per cent of the benefits.

A. That is right.

Q. Could you explain what you mean by that, up to ten per cent of what benefits?

A. Well, we had cases where the railroads felt their [79] benefits would not exceed one or two per cent, and the State Highway Department may have thought that they were more, but under the law, they could not be charged more than ten per cent.

Q. In other words, you say "benefits." You mean the benefit to the railroad?

A. Yes, the railroad.

Q. Could you briefly tell us what the contention of the railroad was, in such situations, where problems arose?

A. Well, many of these grade crossings we were seeking to eliminate had been in existence for years, and the railroads felt like it was the increase in vehicular traffic that necessitated the construction. The railroad traffic generally was on the decline, and they therefore objected to any large assessment of the cost.

Q. Now do you know why there was any problem in determining the amount of the benefit?

Mr. O'Rourke: By that, you mean benefit to the railroad?

By Mr. Langer:

Q. Yes.

A. Benefit to the railroad? Well, to repeat, these benefits are often intangible. The probable accident reduction was one item, and that was rather difficult to de- [80] termine mathematically what that reduction would be.

The operation and maintenance of the crossing itself was a small item in most cases. In other cases, it might be considerable. The train operation—I couldn't tell you how that was affected, whether the trains had to slow down or not. That would be a matter of local legislation, I assume.

Q. These problems that you have referred to, were they problems that only arose in specific instances, or were they general things that affected railroads in general?

A. They were general enough to result in considerable delay, in many, many cases of constructing worthwhile projects.

Q. I know this is going to be slightly repetitious. Could you now tell us how the second memorandum that you referred to solved some of these problems?

A. The second memorandum, issued by the Bureau of Public Roads was——

Q. Which number is that now?

A. That is 325.

Q. GAM 325?

A. Yes—was the result of extensive conferences and discussions between the Association of State Highway Officials and the Association of American Railroads, and the two organ- [81] izations were the Bureau of Public Roads agreed that, under special circumstances, the railroads would pay the full ten per cent and, in other circumstances, they would pay nothing. There was no graduated scale there.

Commissioner Davis: Who made that decision, Mr. Knight?

The Witness: That decision was made by the Bureau of Public Roads, after consultation with the American Association of State Highway Officials and the Association of American Railroads.

By Mr. Langer:

Q. Could you tell us whether this memorandum was made known to the railroads of the United States generally?

A. Yes, it was distributed to all concerned, because one of the requirements is that, before Federal funds could participate, the State Highway Department would have to reach an agreement with the railroad to conform to the requirements of this memorandum.

Q. Well, what would happen if they couldn't reach such an agreement?

A. Well generally, the State Highway Department had recourse to some state public utilities commission or state corporation commission that would issue a mandate on the sub- [82] ject.

Q. Would you describe briefly now the various types—I assume there is more than one type of railway-highway project—and I would like you to describe the various types that there are.

A. Well, we have the installation of warning devices, lights and gates, or both, and we have the elimination of grade crossings through construction of an overpass or an underpass or the relocation of a highway or the relocation of a railroad. There are also grade separation structures, built where no previous crossing existed, and in those cases, the railroad paid nothing.

Q. Now could you please tell us what the railway-highway projects accomplished when they were put in, or what did they accomplish?

A. The warning devices protected the traveling public by giving a warning of an approaching train. The overpass and underpass structures eliminated the possibility of conflict between the vehicular traffic and the railroad traffic.

Q. Could you tell us whether it ever occurred that a grade crossing which first has a protective device should have a railway-highway project associated with it, so as to remove the protective device and install an overpass or [83] an underpass instead?

A. Yes, if due to the delay in traffic or a high accident rate at a particular crossing, it was found justified, we participated in the building of overpasses and underpasses. The signals being removed became the property of the State Highway Department to be installed at some other location.

Q. Would you know if there is any expense involved in maintaining a protective device, such as a signal?

A. Yes, I think that is general knowledge that it costs money to maintain any electrical equipment.

Q. And of course when a highway overpass or underpass is substituted for a protective device, then the maintenance expense on the protective device is also eliminated.

A. I don't understand.

Q. I would assume that, if you took out the protective device and substituted an overpass or underpass, you are saving money on maintaining the protective device.

A. That would be one benefit to the railroad.

Q. Now could you please explain, in some detail, how a locality would go about—if it wanted to have either a protective device or an overpass or an underpass installed at a certain grade crossing—what would be the negotiations [84] or what would happen, if anything? How would they go about that?

A. They could appeal to the regulatory body of the state, under state status, or if they wanted Federal participation in the cost, they would request the State Highway Department to make an application and submit a program to the Bureau of Public Roads for an allocation of funds for that purpose.

Q. Who was to ultimately decide whether a specific grade crossing should be eliminated, by way of a highway project?

A. Well, the Bureau of Public Roads has final approval.

Q. Would you know whether generally it was the railroad that went to the locality and asked for a grade separation or a protective device, or whether it was the locality that went to the railroad first, to ask for a separation or protecive device?

Mr. O'Rourke: Is your question: Would he know?

Mr. Langer: Yes. Do you know, is my question.

By Mr. Langer:

Q. Do you know whether generally one party went to the other, or generally the other party went to one?

A. I only know through correspondence which passed over [85] my desk, where the locality was attempting to get a project for the elimination of hazards.

Q. You say it passed over your desk? Do you mean: in the course of your official duties?

A. Yes.

Q. In those situations that you are familiar with, it was the locality that was requesting it?

A. Yes.

Q. I think you began your discussion of these two documents that you have before you, by mentioning the 1944 statute, and I would like to ask you whether there were any previous statutes dealing with Federal funds, and if there were, would you tell us about them?

A. The Federal Aid to Highways Act, originally passed in 1916 and amended in 1921—it was expanded and included highway improvements, and there was no specific mention in that act of the railway-highway project, but they were eligible, as a highway project, under the regular pro rata. During the depression, the Emergency Relief Act of 1935 made Federal funds available for elimination of hazards at railroad crossings, with 100 per cent Federal funds, and there were other highway acts from then on up, including provision for protection at railway-highway crossings.

[86] Q. Now this 1935 Act that you mentioned—would you know what the purpose of the highway project that it dealt with—what was the purpose?

A. The purpose of that Act was to provide employment for unemployed persons, and to construct worthwhile projects for the community.

Q. By "worthwhile" do you mean also safety projects?

A. Yes. That would include all types of projects.

Q. Would you know whether the purpose of the 1935 statute and the 1944 statute, that you mentioned—whether that purpose was to provide funds that would increase the working capital of the railroad?

A. No, I couldn't answer that.

Mr. O'Rourke: Would you repeat the question and answer?

(Record read)

Mr. Langer: At this time, I would like to offer Defendant's Exhibits Nos. 1-DP and 2-DP for identification, and they are accompanied by a certification of the Records Management Branch of the Bureau of Public Roads and the Department of Transportation.

COMMISSIONER DAVIS: Mr. O'Rourke, do you have any objection?

[87] MR. O'ROURKE: I don't think I have any objection, Your Honor.

COMMISSIONER DAVIS: They will be admitted.

(Documents heretofore marked for identification Defendant's Exhibits No. 1-DP and No. 2-DP were received in evidence.)

COMMISSIONER DAVIS: Do you know where these marks came from on here, on page 3 of 1-DP. It has some writing on the margin. Do you know anything about that? Maybe the witness does.

By MR. LANGER:

Q. Mr. Knight, can you tell us what that writing is on the margin?

MR. O'ROURKE: There is no writing on mine.

MR. LANGER: My copy didn't have writing on it.

THE WITNESS: Evidently before this was run through the Xerox or reproduced, someone made a comment about the current regulations which now apply to this item.

By MR. LANGER:

Q. Do you know what year the current regulation came into effect?

A. 1958.

COMMISSIONER DAVIS: Well, I assume we can disregard [88] any of that.

MR. LANGER: So far as I am concerned, it is after the years involved anyway.

(Discussion off the record.)

By MR. LANGER:

Q. Mr. Knight, I just have a few additional questions. First of all, you mentioned that the statute provided that up to ten per cent would be paid by the railroad in the amount of its benefit, but not more than ten per cent. Am I to understand that the railroads which contested the amount would have the benefit that was allocated to them,

that they were claiming that they were receiving even less than ten per cent benefit from the project?

A. That is correct.

Q. Would you please describe to us how the Federal funds were allocated across the country, among different projects or among different localities, if you know.

A. The Federal Aid Highway funds made available under the 1944 Act, and subsequent Acts, are distributed by formula, based on population, road mileage, and area.

The 1944 Act, in providing an increased percentage of participation by the Federal Government, for railway-highway projects, limited the amount of such funds to ten per cent of [89] the total apportionment to the state.

In other words, on ordinary highway project, the Federal Government would pay fifty per cent and the State would pay fifty per cent. If it included the elimination of hazards at a railway-highway crossing, the State is permitted to use up to ten per cent of their total allocation for such projects, in which the Federal Government will pay ninety per cent or one hundred per cent, depending on what the railway contribution was.

Q. In order to make it clear, could we start again? As I understand it, fifty per cent would be paid by the state, and who would pay the other fifty per cent?

A. The Federal Government, on an ordinary Federal Aid highway project, to the railroad involved.

Q. Where does the ten per cent factor come in, that you just mentioned?

A. Well, ten per cent of the total funds apportioned to a state may be used at the increased ratio.

Q. I see. In other words, a total amount could be apportioned to a specific state and that state would take ten per cent of that total amount and use it on one specific project?

A. Yes, they could use it on a number of projects, involving railway-highway grade crossings.

[90] Q. Now tell us, under what conditions could they use that money, that ten per cent?

A. Well, the condition was for the elimination of hazards.

Q. Were there any other conditions?

A. And the fact that the Federal Government would pay more than the normal fifty per cent.

Q. You mentioned that the 1944 statute allocated funds among the states, on the basis, I believe, of three factors. Could you please state those three factors again?

A. Area, road mileage and population.

Q. By "area" you mean area of the state?

A. Yes.

Q. Was the profit and loss status of the railroad itself considered in allocating funds?

A. These funds were not allocated to the railroad. They are allocated to the State Highway Department for all highway projects.

Q. Now my question is: In allocating the funds, did those who allocated the funds take into consideration the fact that a certain railroad located there was either a profitable railroad or a losing railroad.

A. No, the railroads were not considered in the [91] allocation of funds.

Q. They were not considered at all?

A. No.

Q. In other words, just to tie this up, were the capital needs of a railroad, the need for capital funds—was that considered in allocating these funds?

Mr. O'Rourke: I believe the witness already answered the question. I will object to it.

Commissioner Davis: I think he has. You are zeroing in a little more specifically. I will let him answer the question.

(Question read)

The Witness: No.

Mr. Langer: I have no further questions of this witness at this time.

Cross-examination

By Mr. O'Rourke:

Q. Mr. Knight, am I correct that the purpose of providing to states Federal funds which the state could use, together with its own funds, for the construction of overpasses, underpasses, and railroad protective facilities, was to facilitate the movement of motor vehicular traffic. Is that right, sir?

[92] A. The safe movement.

Knight-Cross

Q. The safe movement? Right, sir, and according to—am I correct, sir, that the general purpose of allocating Federal funds to the state for expenditure by the state, in the connection we are now speaking of, was to provide for the safety of the general public?

A. That is correct.

Q. Am I correct further that one of the problems in determining whether there was any benefit to a railroad, was in determining whether their operations were, in any way, reduced as to effort or expenditure of sums of money? If you don't understand my question, just say so and I will rephrase it.

A. I wish you would.

Q. Strike it.

You indicated that there was difficulty in determining whether there was any benefit to the railroad, derived from the construction of overpasses, underpasses, and protective facilities. Is that right, sir?

A. The difficulty was in determining the amount of benefits, if any.

Q. And that benefit would be derived, am I correct, from saying that it would be an operational benefit, that is, a [93] betterment in your operating procedure, by the railroad. Is that correct, sir?

A. The operational benefit was one of the factors that they attempted to consider.

Q. Attempted to consider?

A. That is right.

Q. And you ultimately found it so difficult that it was decided that it could be no more than ten per cent—the liability could be no more than ten per cent of the total cost of the construction?

A. That is not exactly right. The statute of 1945 limited it to ten per cent.

Q. Just for clarification, Mr. Knight, did you participate and, if so, to what extent, in the promulgation or issuance of Defendant's Exhibits Nos. 1 and 2-DP?

A. No, I did not participate in the preparation of that.

Q. Am I right, sir, that these are memoranda issued by the Public Roads Administration and available to the public generally?

A. That is right.

Q. They were intended as guidance memoranda for the administration of the Federal Aid to Highways Act of 1944. Is that right?

[94] A. That is correct.

Q. Am I correct further, sir, that the Federal Government, as you have described it, would make available to the state certain sums to be expended by the state in highway construction. Is that right?

A. That is right, yes.

Q. And those funds became the funds of that state, for that stated purpose?

A. That is right.

Q. Is that right, sir?

A. Yes.

Q. And accordingly, as to any railroad overpasses, underpasses, or protective facilities, the expenditure for the cost of that construction, to the extent not borne by the railroad, would be borne by the State, out of the funds made available to them, under the Highway Act?

A. That is correct.

Q. And therefore it would not be the Federal Government that would be paying the cost of construction of that overpass, underpass, or protective facility. It would be the state, to the extent that the railroad did not pay the cost of that construction.

A. I will try to answer your question.

[95] Q. All right, sir.

A. The state had this amount of Federal money available. If they did not use it on railway-highway projects, they could use it on other highway projects, but they did not get the money until they had used it on a highway project, approved by the Bureau of Public Roads.

Q. This may be an accounting detail, but did the State have to first spend the sums and then they were reimbursed?

A. They are reimbursed, after the project is completed.

Q. Assuming that it was a 90 per cent overpass—if you will assume that for me, a railroad overpass—the state would pay the 90 per cent and the railroad would pay the ten per cent, and then the state would apply to the Federal

Government for reimbursement of its 90 per cent. Is that right?

A. That is correct.

Q. But the initial payment was made out of State funds, by the state?

A. That is correct.

Q. Now if you know—and you may not know, and it isn't always necessary for the witness to know everything—assume an overpass, a railroad motor vehicular overpass, separation of highway and the railroad right of way; upon the completion of that project, and payment having been made therefore, by the [96] state, and assume the railroad having paid ten per cent, that piece of construction, if I am correct, became the property of the railroad. Is that right, sir?

A. I do not believe so.

Q. I am interested in that. You said earlier that, on protected facilities that were abandoned in favor of a different type of construction, that is to say, an overpass or underpass, the property, that is the protective facilities, became the property of the state. Was that your testimony?

A. Yes, sir.

Q. Can you tell me the source of that statement and let me rephrase that. I am giving you a double question in a way, but we will work it out.

Did the arrangement between the railroad and the state, as to who was the owner of the property depend upon whatever agreement was reached between the state and the railroad?

A. Are you talking about signals now, or structures?

Q. Let's talk about signals.

A. Talking about signals?

Q. Yes, sir.

A. I don't know whether this is admissible.

Q. I asked the question, so you can answer it, sir.

[97] A. I personally saw a decision handed down by a solicitor some years ago, in which he said the maintenance of the signals by the railroad did not give the railroads title.

Q. Can you tell me when that decision was handed down, and this solicitor was employed by whom, sir?

A. The Bureau of Public Roads.

Q. Federal?

A. Yes.

Q. Now can you tell me to whom he rendered that opinion —and it was an opinion?

A. ~~It~~ was an opinion. He delivered it to the Commissioner.

Q. Of the Bureau of Public Roads?

A. Yes.

Q. Are you familiar with the fact—if you will accept it to be a fact, as shown by this report—that agreements were entered into, with respect to, we will say, the erection or construction of protected facilities between the State involved, in which the railroad was operating, and the railroad? Are you familiar with any of those agreements?

A. I have seen quite a number. They all did not pass over my desk, during that period, but I did see quite a number.

Q. But you are familiar with the fact that the con-[98] struction of an overpass, underpass or protective facility was pursuant to an agreement between the railroad and the state?

A. The agreements are required by the memoranda which have been submitted in evidence.

Q. They were between the railroad and the state?

A. And the state, that is right.

Q. And the Federal Government was not signatory, or did not participate in the execution of those agreements?

A. No.

Q. Your answer is no, sir?

A. The approval of the Bureau to the agreement is required before construction is undertaken.

Q. And that approval, sir, goes to the engineering aspects?

A. Yes, it includes the granting of an easement; if one is granted to the state, it sets forth who is to maintain it, the conditions surrounding the construction, such as furnishing a flag man, the reimbursement of the railroad for their expenses and so forth.

Q. So that the state would be in a position to know in what amount it might be reimbursed, out of those Federal funds.

A. Absolutely.

[99] Q. As I understand it, just for clarification, if the state was extending funds for highway construction, which did not include a railroad underpass, overpass, or any railroad protective facility, the expense of that construction was borne on a 50-50 per cent between the Federal Government and the State Government. Was that what your testimony was?

A. Generally the public lands state gets a higher percentage, receives a higher percentage, and of course the interstate highway system is much higher.

Q. Now assuming that that highway construction included the construction of a railroad overpass, then am I correct that you testified that the State could use up to ten per cent of its total allocation of available Federal funds for the construction of such types of construction that is, overpasses, underpasses or protective facilities?

A. No, the use of ten per cent for a project financed at greater than the normal pro rata——

Q. The project financed at greater than normal pro rata which for this purpose, we will say, is 50-50?

A. It is.

Q. And where they are financed on a 90 per cent, that is 10 per cent to the railroad, 90 per cent to the state, then in those instances, you are limited—the state is limited [100] to ten per cent?

Mr. Langer: Excuse me. Did Mr. O'Rourke say 90 per cent to the state and 10 per cent to the railroad?

Mr. O'Rourke: 90 per cent to the state and 10 per cent to the railroad. Strike that question and I will ask it again.

Mr. Langer: Before the question is asked, am I to understand——

Mr. O'Rourke: Let me take the witness on cross and you can take him on redirect, and we will see if we can get these numbers straightened out.

By Mr. O'Rourke:

Q. You understand what I am trying to do. You testified earlier about a 50-50 and then you testified about 10 per cent of the total, and I am trying to get straight for the record what we are talking about.

I understand you to say that, with the normal pro rata, which we will say is 50-50, as between the State and Federal funds, is not applicable and as in the case of a highway overpass, where the pro rata was, we will say, ten per cent to the railroad and 90 per cent to the State, that the State would be limited to using not more than ten per cent of the Federal funds allocated to that State, if they wished [101] reimbursement out of Federal funds.

A. Yes.
Q. Is that correct, sir?
A. Yes.

* * * *

TRANSCRIPT OF PROCEEDINGS

[Chicago, Illinois (Crown Point, Indiana), January 15, 1968]

THE COMMISSIONER: Let the record show that we have reconvened at Crown Point, Indiana, at the residence of Col. John Wheeler.

Mr. Schreiber, you may proceed.

COL. JOHN W. WHEELER,

a witness produced on behalf of the plaintiff, having been first duly sworn by said Commissioner, was examined, and in answer to interrogatories, testified as follows:

DIRECT EXAMINATION

By MR. SCHREIBER:

Q. Would you please state your name and address?
A. John W. Wheeler, Box 236, Crown Point, Indiana.
Q. Are you presently retired, Col. Wheeler?
A. I am.
Q. How long have you been retired?
A. Oh, I have been completely retired for about eight years, seven or eight.
Q. By whom were you employed immediately prior to your retirement?
A. C. B. & Q. Railroad, Chicago.

* * * *

[20] Q. And you were in service at that time, is that correct?

A. Yes.

Q. Getting back to the time when you were with the Indiana State Highway Commission——

A. Yes?

Q. —what was your understanding of this Federal Aid Highway program that was enacted in 1933 that you referred to previously?

A. We didn't understand much of anything. We knew that President Roosevelt, upon sizing up the situation, wanted to put men to work, and highways was one of the avenues that suggested itself, and because someone told him that there was more hand labor in bridge work than there was in just state highway work, apparently they got into the grade separation program.

Q. Actually how was the program implemented in Indiana when you were a member of the Commission with railroad separation projects and/or signal projects?

A. Well, they were both the same. We won't go into the signal work because there are so many of them and they are such small change.

Q. You mean it is the same principle you apply?

A. It is the same thing, and it is so small. [21] I didn't handle those. Mr. Essman, in my day, handled them.

Q. Mr. Essman is employed by the Chicago, Burlington & Quincy Railroad Company?

A. That is right. Signal engineer is his title, I think.

Q. But isn't it a fact that you did negotiate some of these signal agreements that later were implemented by Mr. Essman and his people?

A. Yes, I think—I would get out here some place and they would say, "How about a signal here?"

And I would say, "Fine." And I reported back and he would handle it.

Q. Getting back to the time you were with the Indiana State Highway Commission, would you describe your experience there in regard to negotiating with railroads?

A. Yes, as soon as this act was passed the Public Roads Administration, known as the Bureau of Public Roads then, informed us what would be money available, set up for each

state on the basis of ratio of miles of area road to the railroad mileage in that state, that the money would be parceled out in that ratio. For instance, in Indiana, it happened to be [22] that the New York Central was the high mileage railroad, and then on down. We would notify, for instance, the New York Central that we had so many hundred thousand dollars which could be used for grade crossing elimination on their railroad and we would like to recommend crossings A, B, and C, would their representative, at his early convenience, come to our office and tell us how he felt on our choice, and perhaps we could alter it somewhat to his choice.

Q. Now, what factors did you consider in making the original selection of proposed separation facilities?

A. Well, we knew what was in the mind of the Public Roads Administrators. Number one was put men to work. The second was to speed up highway travel. We knew that. They told us that.

Q. Speed up highway travel?

A. Yes, so they wouldn't have to wait for long freight trains. They would like to separate the grade for safety and so they would not have to wait for long trains, so knowing that was in their mind—you see, they finally had to pass, no matter what New York Central and Indiana did, that advance had to be approved by the Bureau of Public Roads.

* * * *

[34] Q. Did the Burlington return any services to the state or municipal body in connection with these projects?

A. We rendered service but they paid for it. For instance, if it was a dangerous situation we would put a watchman on. We kept track of the watchman's time and billed them and they paid it.

Q. Now, did the Chicago, Burlington & Quincy Railroad Company garner any benefits from any of these projects?

A. Well, there are many intangibles. I imagine we received a lot of good will from people who had been held up by freight trains and now were not held up.

Q. Actually, aren't they the persons or individuals that received the benefits by the fact that they no longer had to wait for a freight train?

A. Oh, yes. They were——

Q. Excuse me, go ahead.

A. No, that is it.

Q. The Burlington Railroad wasn't able to run the trains faster or anything?

A. Oh, yes. For instance, when we were going through Brookfield at the grade we didn't just highball through it. And when we got separation there we went [35] faster on those trains that didn't have to stop. That was by our own volition. It wasn't by ordinance or anything.

Q. Some of these municipalities have a speed ordinance in their city limits, do they not?

A. Any of them can put them there if they want it.

Q. Did the Burlington Railroad return any services such as stopping passenger trains where no passenger trains stopped before, in connection with these projects?

A. No.

Mr. Schreiber: I believe that is all I have.

The Commissioner: Do you want to confer?

Mr. Schreiber: I want to confer just a minute, if I may, sir?

By Mr. Schreiber:

Q. Now, Col. Wheeler, would you define what you mean by bridge separation?

A. Bridge separation?

Q. Yes, overpass?

A. Oh, it is an overpass if the highway goes [36] over the railroad. It is an underpass if the railroad goes under the highway.

Q. And would you define what is meant by the term "grade separation?"

A. A grade separation is where the railroad and the highway cross at the same elevation on the ground.

The Commissioner: I don't understand that, Colonel. You say they cross at the same——

The Witness: Well, the same elevation or a slight change, but it is on the ground. I don't know how to say it any better. If the ground is flat they cross it exactly flat.

The Commissioner: What does the word "separation" then mean?

THE WITNESS: Well, that separates the railroad and highway.

By MR. SCHREIBER:

Q. And what do you sometimes find at such a location—signal protection?

A. Well, there are many signals. A job that [37] isn't considered to be worthy of a large expenditure gets an electric flasher, and that is a signal.

Q. But the term grade separation, does that mean that the grade of the railroad where it crosses the highway or road of some sort, is that just a railroad term to distinguish a ground level crossing on a railroad?

A. No, that is accepted by everybody. Now a grade crossing did you say?

Q. Grade crossing and/or—well, that is a grade crossing, is that correct?

A. That is a grade crossing.

Q. Now, would you distinguish, if there is any distinction, between that and the grade separation?

A. Oh, yes. The grade separation, one—either the highway or the railroad—crosses several feet above or below the other.

Q. That is what you referred to before as either an overpass or an underpass or a subway?

A. That is right.

Q. Now, I hand you a document. For purposes of identification this is a copy of Joint Exhibit [38] 5 which was attached to the stipulation.

Do you have a copy?

THE COMMISSIONER: Yes, we both have a copy.

By MR. SCHREIBER:

Q. Are you familiar with that document?

A. Oh, yes.

Q. Have you looked over that document as to each particular project?

A. Yes.

Q. Now, does your testimony that you have given today apply to each one of those particular projects?

A. No, sir, it does not, but if you will note the date on

them, some of them were negotiated and built before I came to the Burlington.

Q. That is correct, but you have had an opportunity to look at some representative agreements on that Joint Exhibit 5 which you did not personally negotiate, is that right?

A. That is right.

Q. Were they along the same line as the agreements you negotiated?

[39] A. No. You see before, there was a period before the Federal Highway Act was passed that they were negotiated between the railroad and state public service commission which adjudicated the division of cost as they saw fit.

The Commissioner: Division of cost—go ahead.

By Mr. Schreiber:

Q. The division of cost of a particular project, is that correct, instead of one hundred per cent payment by the state that might be fifty-fifty or twenty-five-seventy-five, is that correct?

A. Oh, yes.

Q. But whatever percentage—excuse me.

A. Yes, sir, you are correct. They generally finished up by the State Commerce Commission causing the railroad to pay a little more than half of it.

Q. But over that there still remained a certain percentage which was paid by the state or municipality, is that correct?

A. Well, the state had to pay or the municipality, the county, I don't know. I don't know who. Say that was the Illinois Commerce [40] Commission. Who brought this up? Who wanted this separation? We will say Winnebago County. They decided that the Burlington Railroad should pay so much and Winnebago County had to pay so much.

Q. But the County did pay some percentage, whatever it might be?

A. Oh, yes.

Q. And it would be no different from the projects you negotiated except from the division of cost percentage-wise?

A. That is right.

The Commissioner: You say it was no different, would you clarify the previous answer?

You say it was no different. Is this from your review of contracts which were made prior to the time you were in the position in which you previously testified?

You can expand on that, Mr. Schreiber.

Mr. Schreiber: Yes. If the Colonel——

The Witness: Well, now, you will have to clarify your question.

[41]

By Mr. Schreiber:

Q. May I ask a question, maybe that will clarify it?

A. Yes, sir.

Q. Now, when you became employed by the Burlington Railroad there were contracts that had been negotiated prior to the time you permitted employment by the Burlington, is that correct?

A. That is right.

Q. Did you have opportunity to review those contracts?

A. Oh, yes.

Q. Now you have testified that prior to this Federal Aid Highway Act various states would enact orders by the state commissions requiring the Burlington Railroad to, perhaps, install a crossing protection at a particular location?

A. Yes.

Q. That was done on petition to the commission by various residents of that area, is that correct?

A. Yes.

Q. Then the commission would enter an order?

[42] A. That is right.

Q. Setting up a division of cost?

A. That is right.

Q. If the Burlington Railroad had completed the same project subsequent to the time of the Federal Aid Highway Act they could have received the entire amount from the federal government or the state government for the same project, is that correct? Assuming it was approved by the state highway commission?

A. After the Federal Highway Act of 1933 was passed the railroad had to pay nothing.

Q. Now, as it was before then the railroad had to pay some?

A. Yes.

Q. The state still paid something, is that correct?

A. Oh, yes.

Q. There were no factual differences between the particular projects?

A. No, if I understand your use of the word "factual" ——

The Commissioner: Well, explain [43] what you mean by that and then clarify between the two of you.

Mr. Schreiber: O.K.

By Mr. Schreiber:

Q. Well, Colonel, if at a point, say in Winnebago County, Illinois, there was a crossing of railroad and highway——

A. Yes.

Q. —and it was desired to install signals, crossing protection—flasher lights and gates?

A. Yes; not gates—well, full gates had been invented. The half-arm gate came later. Go ahead.

Q. Let's just take it with flasher lights.

A. Go ahead.

Q. The fact is an installation of flasher lights is desired to be installed at this particular crossing in Winnebago County, now prior to the passage of the Federal Aid Highway Act that you referred to previously, then somebody went to the state commission to get an order to install a flasher light at that point—it is the same flasher light we talked about subsequent to passage [44] of the act——

A. That is right.

Q. —but prior to passage of the act the commission would enter an order proportioning the cost on some basis?

A. That is correct.

Q. And the Burlington would pay whatever the commission ordered?

A. Well, I don't remember how you appeal on that. I don't think the railroads appeal from it much. By the time I got to the Burlington we didn't have to contend with the federal highway in Indiana. Of course, I had nothing to do with it there either. It was a matter between the railroad and the Public Service Commission in Indiana.

Q. Getting back to when you first became employed by

the Burlington you did review contracts that had been entered into between the Burlington and various state bodies prior to the time you were employed, did you not?

A. Oh, yes.

Q. And some of these pre-dated the passage [45] of the Federal Aid Highway Act, wouldn't they?

A. Oh, yes.

Q. Was the terminology used in the particular agreement the same as that used in the agreements you negotiated except for the additional cost?

A. Now, you will have to clarify that question—terminology.

Q. Let's take an example.

The Commissioner: Let me ask this: Were the basic provisions of contracts essentially the same except for the division of payment existing between the federal government after 1933 and the states or municipalities prior to 1933 with respect to those like installations of flasher signals?

Does my question make sense to you?

Would you read it?

(The question was read by the court reporter.)

The Witness: Well, you must understand there were fifty state service commissions. For instance, in Texas it [46] was the Railroad Commission. In Illinois it was the Illinois Commerce. In Indiana it was the Public Service Commission. There was fifty of them, and how they worded those I suppose there were fifty different ideas.

The Commissioner: I appreciate that would be true, but generally speaking the provisions did not change after 1933 to what they had been previous to 1933, is that correct?

Mr. Schreiber: May I give the witness those exhibits?

The Commissioner: Yes, you may.

By Mr. Schreiber:

Q. I hand you Plaintiff's Exhibit 10 and Plaintiff's Exhibit 13 and I ask you to examine those documents.

The Commissioner: What is the date on that?

The Witness: '24, 1924. I would have no idea.

By Mr. Schreiber:

Q. Have you examined the document Plaintiff's [47] Exhibit 10, have you looked it over?

A. Well, now, I can't see how long—I can't say that I have read it enough to discuss it intelligently because of the date.

Q. Yes, but does it provide for a subway, is that the intent of the agreement?

A. That it does, for a subway division of cost of subway; half, the Department of Public Works and Buildings and one half to the Chicago, Burlington.

Q. I ask you to look at Plaintiff's Exhibit 13 if you would like to look at the date in question. Do you see the date of that agreement?

A. Yes.

Q. What is that date?

A. 1953. All right, now, what is your question on that?

Q. I have asked you to examine that document and see what it provides.

A. This provides for gates.

Q. That is installation for crossing protection?

A. That is right, single-arm gates and [48] combination of flasher light signals.

Q. Well, let me hand you Plaintiff's Exhibit 9. You can see on the front page of the document that it is dated February——

A. '35.

Q. 1935. What does that agreement provide for?

A. It asks for a separation.

Q. Now, handing you again Plaintiff's Exhibit 10 to be read along with Plaintiff's Exhibit 9. Do both Plaintiff's Exhibits 9 and 10 provide for the same type of facility, that is a subway?

A. Well, this one calls for a subway.

Q. You are referring to Plaintiff's Exhibit 10?

A. Yes.

Q. Does Plaintiff's Exhibit 9 also provide for a subway?

A. That is right, both of them.

Q. Now, the one you testified to previously, Plaintiff's Exhibit 10, provided for a division of cost, fifty per cent to the state and fifty per cent to the railroad, is that correct?

[49] A. That is correct.

Q. Now, I ask you to look at Plaintiff's Exhibit 9, and if you will take this and look through it and tell us what the division of cost is in connection with that project?

A. From the document submitted therewith——

The Commissioner: What page are you reading from, so we can have that in the record?

Mr. Schreiber: Page 6, the Colonel is reading from the last page.

By The Witness:

A. (Reading):

> "It is understood that the state expects to be reimbursed by the federal government for all expense incurred in the performance of this agreement, and the state shall not make final payment to the railroad for work performed for the railroad until all the federal authorities approve said work and bills of expense submitted thereto."

Q. That was on Page 6 of Plaintiff's Exhibit [50] 9. Now, referring again to Plaintiff's Exhibits 9 and 10, which you have before you, other than the different percentage division of cost, are the provisions in those agreements substantially identical?

A. Very near, yes.

The Commissioner: Well, the documents speak for themselves.

Mr. Schreiber: Well, that is right. That is all I have.

Mr. O'Rourke: If you will excuse me, sir.

(Following a conference between counsel, the hearing was resumed as follows:)

By Mr. Schreiber:

Q. Col. Wheeler, on these agreements, prior to the passage of the Federal Aid Highway Act in 1933, to the best of your knowledge, from your examination of the books and records of the plaintiff, was there any indication that any benefits were received or any compensation paid by the plaintiff to any of these municipal bodies?

[51] A. Prior to when—the Federal Highway Act?

Q. Yes, sir.

A. Why, yes. They paid whatever——

Q. I am talking now just about what proportion or percentage which the state bore the cost. For example, in this Plaintiff's Exhibit 10 you testified it was fifty per cent by the railroad and fifty per cent by the state, is that right?

A. Yes.

Q. Now, for that fifty per cent contributed by the state, were there any benefits received or any additional compensation paid by the railroad other than its fifty per cent share of the cost?

Mr. Langer: Excuse me, Counsel, benefits received by whom?

Mr. Schreiber: By the railroad.

The Witness: Both of you are confusing me on that one. The Commerce Commission has set this. Apparently the railroad did not appeal, and paid. That is all I can say.

By Mr. Schreiber:

Q. The railroad paid whatever the Commission [52] ordered, is that correct?

A. It looks that way. I can't see any appeal.

Mr. O'Rourke: Will you indulge us just a moment?

The Commissioner: Yes.

By Mr. Schreiber:

Q. Now, Col. Wheeler, were any services rendered by the plaintiff to any of these states or municipal bodies?

A. You understand I am not a lawyer. Let's change the word "plaintiff" to something else.

Q. Were any services rendered by the Chicago, Burlington, & Quincy Railroad Company to the state or municipal bodies in connection with these agreements other than what the division of cost against the railroad was?

A. No.

Q. Well, there was no compensation paid other than the exact percentage set by the Commission, is that correct?

A. That is right. Why should the railroad pay any more than the Commission demanded?

[53] The Commissioner: Anything further?

Mr. O'Rourke: No further examination.

The Commissioner: Would you like to take five minutes to collect your notes? Let's take five minutes to walk around.

Mr. Langer: It is O.K. with me.

(Following a short recess the hearing was resumed as follows:)

[54]

Cross examination

By Mr. Langer:

Q. Mr. Wheeler, you realize, of course, that when I cross examine you I am not trying to mix you up in any way. We are just here to get some of the facts that relate to this case, and if I ask anything that seems not to make sense, just stop me and we will try to correct it because we are not trying to mix anybody up. We are just trying to get some of the facts clear.

You mentioned you were the executive assistant to the president from 1938 until approximately eight years ago?

A. Minus the—oh, I was back from the Army then, wasn't I—no, minus the six war years, yes.

Q. So that during those years, say from 1938 on, you had no personal knowledge of what was going on in the state highway authorities, what kind of policies they had internally when they dealt with you?

A. In my eleven states?

Q. Yes, your eleven states?

[55] A. Yes, I knew very well because we were very frank in discussing them. These were friends of mine. I made it a point to make friends of them. They knew me.

Since I became involved in this, knowing that I was going to give this testimony, I have exchanged a letter with Rex Whitton, who knew exactly what I know.

When I was Commissioner in Indiana Rex was a maintenance engineer in the State of Missouri. He later was made head of the Bureau of Public Roads by President Kennedy, held over by President Johnson until he was sick and worn out and went back to Missouri.

Q. You stated during this period you dealt with bodies politic?

A. That is right.

Q. What do you mean by bodies politic?

A. Bodies politic, I mean townships, counties, cities, villages, states, United States, period.

Q. So you dealt with the highway representatives of those bodies politic?

[56] A. That is right.

Q. And prior to that time when you were with the State of Indiana, that was from 1933 to about 1937?

A. That is right.

Q. At that time you actually knew what the internal policy of Indiana was because you were in it?

A. I set it.

Q. You set the policy?

A. Sure, that is what the government got me for.

Q. Well, then wouldn't you agree there was some sort of a difference between what you knew when you were working with Indiana setting the policies and what you knew in those years afterward when you were with the railroad?

A. Well, I conformed as quickly as I could. See, I had only been there two or three months when the Federal Highway Act of 1933 was passed, and then they all conformed to that act.

Q. Well, do you mean the state highway officials conformed to that act?

[57] A. Yes, sure.

Q. So whatever the act was the same policy——

A. Surely.

Q. —was the same policy of the highway commission?

A. All highway commissions.

Q. Was that same true in other words, that the highway commission had the same policies?

A. Sure. You see that highway act was amended from time to time and the states changed just as fast as they could because they wanted the advantage of the accrued.

Q. Could you tell me what the advantages were that accrued that caused the states to change, as you say, could you explain that?

A. Known as federal aid. Now if you can define federal aid you are the only man I know who can define federal aid, but they call it federal aid. That is your money and my

money with the corner cut off of it and sent back to us, is all I know, but anyway that is the kind of money that came back to us and it was better than no money, so we all wanted our share of it.

Q. Well, the states wanted the money for the purpose we have been talking about?

[58] Q. And could you tell us why the states want these protection facilities?

A. Oh, the state had many reasons for wanting to do this. The primary reason was they wanted to beat the state commission from demanding it and making us pay for it, making us—the railroad—pay for it. And this was the sure way out of that.

Q. You mean that the states wanted to save the railroads the money so they tried to get it through the federal statute?

A. No. I said we wanted it for fear the state would follow up and want this separation built and assess part of the damage to us. No, sir.

Q. You mean to the railroad, is that right?

A. To the railroad.

Q. You told me now from the railroad's point of view?

A. Yes.

But that was not my question. My question was when you were on the state highway commission you state that the states had this policy of trying to conform to the federal policy?

A. That is correct.

[59] Q. And you said the states want it because they get something out of it?

A. Oh, yes.

Q. Now, we are discussing what did they get out of it?

A. Well, they got ninety per cent of the cost of these separations.

Q. O.K. Could you tell me why do they want the separations? They got the money, why did they want the separation?

A. Well, they wanted the separations first, I suppose, to go along with the president and make work; second, to make the transportation safer at that point; and third, perhaps, to make it move more rapidly.

Q. Were the states really interested in making the railroad move more rapidly?

A. With safety I think they would be glad to get them out of the way.

Q. For safety, but they really weren't interested in moving the cars, they did not care how the railroads moved, is that right?

A. No, you are quite right.

[60] Mr. Schreiber: May I object there, just for clarification? I think there is some conflict here. You asked him a question of what the estates hoped to get out of it. He answered that question by saying that transportation would be safer and that there would be more rapid transportation and move more rapidly.

Now, I think it should be clarified as to for whom the transportation was going to be safer, for whom the traffic is going to move more rapidly. If I might ask that for clarification.

Mr. Langer: O.K., but it has no bearing on what I am trying to find out.

Mr. Schreiber: I thought your follow-up question made an assumption it was safer for the railroad. I just wanted to get it clarified.

The Commissioner: What do you mean by traffic, do you mean railroad traffic or highway traffic?

The Witness: Both.

[61] The Commissioner: Proceed, Mr. Langer.

By Mr. Langer:

Q. Well, let's start again.

Mr. Wheeler, as I understand it, we are now talking about why the states wanted to get this federal money.

A. Yes.

Q. Good. Now one of the reasons they wanted it was safety?

A. One of them.

Q. O.K. Now could you explain what the safety was that the states were getting?

A. Well, if they got the grade separation, the two of them wasn't on the track when a locomotive came along.

Q. And the state was interested in not having automobiles on the track?

A. Yes, the state did not like to have that.

Q. For the reason they didn't like it because they wanted to keep their inhabitants alive?

[62] A. I think that was it.

Q. Now, you also mentioned that when a local community felt any situation was unbearable they went to the highway commission and asked that the——

A. No, no. Now, is this ahead of the Federal Highway Act?

Q. Well, I am really not certain, I am not certain with respect to when you said——

A. Just tell me which way you want it.

Q. I guess at this time we should start at the beginning and we will find out both ways.

A. All right.

Q. Would you first tell me before the Federal Highway Act in 1933?

A. They went to the Commerce Commission in Illinois.

Q. And after 1933, after that act?

A. After that act they went to the highway commission.

Q. Let's start before that again. They went to the state commerce commission?

A. Yes, that is right.

Q. If they felt a situation was unbearable [63] and they felt it should be remedied?

A. That is right.

Q. Can you explain what you mean by "unbearable?"

A. Oh, there were too many accidents, killing too many people.

Q. Could you describe, if you know, what they would do when they went to the commerce commission? How would they go about that?

A. Well, they took attorneys down there and stated their belief.

Q. Generally what was their belief?

A. That the situation was unbearable.

Q. Again because of accidents, because people were geting killed?

A. Yes. That was the worst thing.

Q. And was that the same after the Federal Act was passed except that now they would go to the state highway commissions?

A. That is right.

Q. They would go down and petition that the railroad would be forced to build a safety crossing or safety device?

[64] A. Well, yes, they went down a great deal. They were always coming down. I think they liked to come down. They could have handled it by letter but they came down.

Q. Now, you also mentioned before that the railroads didn't have to slow down when there was an overpass or a subway?

A. Yes.

Q. And I think I also asked you a question—I would like you to answer it now—whether the community, when they asked for an overpass or underpass, were they interested in whether the railroads went quickly or slowly or whether they mostly were interested in not having accidents?

A. I think they were mostly interested in not having accidents.

Q. In fact, unless they were shipping goods on the train they didn't care whether it was quickly or slowly?

A. I think that is right.

Q. Now, as I understand it, you say around in 1932 FDR wanted to get people to work, and that was part of the reason for having this federal aid, [65] is that correct?

A. Oh, yes, that is correct.

Q. You mentioned that. Could you tell me, to your knowledge, about the construction that went on before that federal act by FDR, could you tell me what, in your opinion, was the main reason for that construction, for the construction that was before FDR's legislation?

A. Well, I don't understand that question at all.

Mr. Langer: Would you read the question?

(The question was read by the court reporter.)

Mr. Schreiber: Do you want to restate the question?

Mr. Langer: I understand it but I will re-state it in a way that everybody understands it. One of the reasons—

THE WITNESS: You will have to get over a little farther. My neck don't work.

By MR. LANGER:

Q. One of the reasons, after FDR rose, was [66] to get people jobs?

A. Yes.

Q. What was the reason before FDR's legislation, when we didn't have this reason, what was the reason?

MR. O'ROURKE: Excuse me, you mean for the construction projects that took place prior to 1932?

MR. LANGER: That is it exactly.

By THE WITNESS:

A. The state highway was charged with improving the— well, do you want to know the intent of the legislature that set up the highway? Well, they helped us out.

The legislature would pass a law, the first highway law. It said the state of so-and-so will form a highway commission which will build a highway known as the state highway connecting each county seat with each other county seat. That was it.

So, they started out and they began the first Illinois or Indiana or Ohio State Highway.

Q. Go ahead.

[67] A. That is it.

Q. So that is how the state decided to build a highway?

A. Yes.

Q. O.K. Could you tell us when they decided to build a crossing—overpass or underpass?

A. When?

Q. No, when they decided to what was the purpose for deciding it?

A. As I told you, I don't think the state ever decided to do it. The people in the locality brought action to have this established before the state commission.

Q. So that if the state decided to build a highway, then they built the highway, and say the highway would cross the railroad, then the people in this locality where it crossed would go to the commission?

A. Yes.

Q. And you discussed that before, right, why they went to the commission?

A. Yes.

Q. You mentioned that when the statute first [68] started, in the time of FDR, the Bureau of Public Roads would decide when to build the crossings by comparing ratios of railroad miles. I wish you would explain that a little more, because that is the first time I have come across it and I would like to understand it.

A. All right. Now, the Bureau of Public Roads, I will give you an example, would notify the State of Indiana that on such a date there was $200,000 available for the railroads for grade separation signals, etc. And this would be given to the railroads on the ratio of number of miles that railroad had in Indiana to the total railroad miles in Indiana.

Q. So that the money was appropriated by Congress through the Bureau of Public Roads, and appropriated directly, so many dollars to this railroad and so many dollars to that railroad, based on their mileage?

A. It was appropriated by the State Highway. The State Highway was informed that it was available to them on this ratio basis.

The State Highway then told the * * *

* * * *

[84] than the others?

A. Well, it had several comical features that amused me and I always remembered it better.

Q. I see. And do you remember what the reason was that they decided to put up an overpass or underpass in York, Nebraska, on that specific contract?

A. Why they wanted it?

Q. Yes.

A. Well, I think they wanted to get the railroad off their main street, is what I think.

Q. The railroad was on the main stret in York, Nebraska?

A. Sure.

Q. Is that possible?

A. Why, sure, crossed it.

Q. The railroad crossed the main street?

A. Sure, Practically every town in the United States it did it.

Q. I see. And the city didn't want it on the main street?

THE COMMISSIONER: You are saying that the railroad crossed the main street. [85] When you say it is on the main street, you mean at some point on the main street it crossed the railroad tracks?

THE WITNESS: Yes.

THE COMMISSIONER: And therefore, they wanted an overpass or an underpass?

THE WITNESS: That is right.

THE COMMISSIONER: To aid in easing congestion on the main street and so on, is that what you are saying?

THE WITNESS: Sure.

By MR. LANGER:

Q. Now, in this specific case I think you mentioned that they came to you—that means the city came to the railroad—the city came to the railroad and said, "We want an overpass or an underpass?"

A. Yes.

Q. O.K. When you used to negotiate for the railroad did you ever go to the city and say, "We want an overpass here."

A. Yes, we would go and suggest that we build a separation there, yes.

[86] Q. How often did you used to do that? Was that very frequently? Which one was more frequent?

A. More frequently, that is a kind of a hard mathematical problem; not frequent—fifty-fifty.

Q. Sometimes they came to you and sometimes you went to them?

A. That is right.

Q. And when you went to them and you said, "Give us a crossing," what were the reasons that you gave?

MR. O'ROURKE: Wait.

MR. LANGER: Overpass, I am sorry.

THE COMMISSIONER: Wait. In what position is he?

Mr. Langer: He is on the railroad. We are talking about the railroad again.

The Witness: Am I on the Burlington?

Mr. Langer: Yes.

The Witness: All right, now state your question.

By Mr. Langer:

Q. And you go to a city or locality and you [87] say, "Give us an overpass or an underpass," you had to give him a good reason. If not he wouldn't listen to you?

A. Well, yes. You are correct. We had to give him a reason.

Q. Would you tell us what they were?

A. Yes. We could save the City of Brookfield a lot of delay, particularly because it is a division point and we break up trains here, and we would say, "We are bound to delay you. You are pretty good because this is a Burlington town, half of you are on our payroll, but we think it would be good for you."

Q. Could you explain why? Because it is a division point what does that have to do with an overpass or an underpass?

A. That puts a lot more traffic on the crossing because at a division point you break up trains and re-make them.

Q. Oh, so they are running back and forth more?

A. That is right, across the crossing.

Q. I see. So the people are willing to put [88] in an overpass or underpass and pay for it?

A. Yes.

Q. And they would be willing to do it because it benefits them?

A. Sure.

Q. And that is also for the reasons you mentioned before?

A. Sure.

Q. For the benefit of the people so they would be willing to do it?

A. Sometimes they would be influential. They got a little stubborn in Brookfield but we handled it.

Q. Again I wish to repeat this because I don't want anybody to get the wrong idea. I am just trying to find out the facts, so if I keep on telling what you said and asking you

about it, I don't mean anything. I am just trying to find out what the facts are.

You also said some of those cities want a watchman and the railroad put up the watchman and then the railroad sent the bill to the city. Can you discuss that more for us?

* * * *

[94] money so we are going to build you an overpass," so that you could have more money. Did they ever say that to the railroads?

A. We told them what their money was they had coming, which had been set up by the Bureau of Public Roads on the ratio which I explained.

Q. Let me ask you, do you know what working capital is, the term "working capital?" That is a technical term. Could you tell me what that means?

A. Well, I think I know.

Q. Would you tell me what it means?

A. Well, if I was in the contracting business and I had a hundred thousand dollars in the bank that was my working capital.

Q. Good. That is what mine is also.

When you were working for the state did you ever go to the railroad and say, "We would like you to have more working capital, so we want to give you an underpass or an overpass?"

A. No.

Q. You never did?

A. No.

Q. Was that one of the reasons that you [95] wanted more money?

A. No.

Q. Let's go farther. When you were with the railroad did they ever come to the railroads in other states, and did the states or the localities ever come to the railroad and say, "We want to make sure the railroad has more working capital so we will give them an overpass or an underpass?"

A. No.

Q. Never told you that?

A. No.

Q. I just have a few more questions, because it is getting late.

Could you explain to us how the estimate was made as to how much an overpass or underpass would cost? Was that your job also?

A. Why, sure.

Q. Would you explain it?

A. Wait a minute. If it was an overpass where the highway went over the railroad the chief engineer of the highway made the estimate.

Q. State highway now?

A. Yes.

SUPREME COURT OF THE UNITED STATES

No. 72-90

UNITED STATES,
PETITIONER,

v.

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

ORDER ALLOWING CERTIORARI. Filed October 24, 1972.

The petition herein for a writ of certiorari to the United States Court of Claims is granted.

Mr. Justice Powell took no part in the consideration or decision of this petition.

☆ U.S. Government Printing Office: 1972—488-232/296

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	4
Reasons for granting the writ	8
Conclusion	20
Appendix	1a

CITATIONS

Cases:

Brown Shoe Co. v. *Commissioner*, 339 U.S. 583 ... 7, 8, 10, 51, 13, 14, 19

Chicago, Milwaukee, St. Paul & Pacific Railroad Co. v. *United States*, 586 Ct. Cl. 250 ... 18, 19

Detroit Edison Co. v. *Commissioner*, 319 U.S. 98 ... 8, 10, 11, 14

Fribourg Navigation Co. v. *Commissioner*, 383 U.S. 272 ... 9

Helvering v. *Lazarus & Co.*, 308 U.S. 252 ... 14

Massey Motors, Inc. v. *United States*, 364 U.S. 92 ... 9

Nashville, C. & St. L. Ry. v. *Walters*, 294 U.S. 405 ... 12

United States v. *Ludey*, 274 U.S. 295 ... 9

Weiss v. *Wiener*, 279 U.S. 333 ... 14

Statutes:

Federal-Aid Highway Act of 1944, c. 666, 58 Stat. 838:

Sec. 1 ... 6

Sec. 5(a) ... 5, 6, 13

Sec. 5(b) ... 5, 13

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.), Sec. 113(a) ... 3-4, 7, 8, 9, 10, 15

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 118 ... 17

Sec. 167(a) ... 2, 9

Sec. 167(g) ... 2, 9

Sec. 362 ... 15

Sec. 362(a) ... 10

Sec. 446(e) ... 19

Sec. 1011 ... 3

Sec. 1012 ... 3

Sec. 1052(c) ... 10

National Industrial Recovery Act, June 16, 1933, c. 90, 48 Stat. 195:

Sec. 204 ... 5

Sec. 204(a)(1) ... 6

Retirement-Straight Line Adjustment Act of 1958, Public Law No. 85-866, 72 Stat. 1606, Sec. 94 ... 19

Miscellaneous:

Treasury Regulations 111, Sec. 29. 41-2 ... 19

In the Supreme Court of the United States

OCTOBER TERM, 1972

No.

UNITED STATES OF AMERICA, PETITIONER

v.

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the decision of the United States Court of Claims with respect to one issue.

OPINIONS BELOW

The opinions of the Court of Claims, which have not yet been officially reported, are set forth in the Appendix, *infra,* pp. 1a–80a.

JURISDICTION

The decision of the Court of Claims was issued February 18, 1972, although the final judgment resulting therefrom has not yet been computed.[1] By

[1] The court held respondent was entitled to the refund which it sought, but it deferred the computation of the amount thereof pending subsequent proceedings pursuant to its rules (see App., *infra.*, p. 80a).

order of Chief Justice Burger, the time for filing a petition for certiorari was extended until July 17, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1). See *United States* v. *Caltex, Inc.*, 344 U.S. 149; *Greene* v. *United States,* 376 US. 149, 153.

QUESTION PRESENTED

Whether, in the computation of its taxable income, respondent railroad was entitled to deduct allowances for depreciation with respect to the costs of certain facilities constructed at highway-railroad intersections, which were paid for not by respondent but out of public funds appropriated for the development of highway systems.

STATUTES INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

Section 167. Depreciation.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(g) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect to any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

* * * * *

Section 1011. Adjusted basis for determining gain or loss.

(a) *General Rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.

*   *   *   *   *

Section 1012. Basis of property—cost.

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). * * *

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):

Section 113. Adjusted basis for determining gain or loss.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

*   *   *   *   *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the

consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

STATEMENT

Respondent, an Illinois corporation, owns and operates an interstate railroad. Beginning in the early 1930's, many state governments entered into agreements with railroad companies, including respondent, relating to the construction of underpasses, overpasses, grade-crossing protection equipment, and other facilities at highway-railroad intersections. The initial agreements made with respondent provided that respondent would perform that part of the construction work most directly related to railroad use, such as bridges and track signal lights, and that the states would perform the work relating primarily to highway use, such as roads and approaches for motor vehicles. These agreements also provided that the states would pay from 50 percent to 100 percent of the total cost of all the work, including the work performed by respondent (App., *infra*, p. 56a).

After the initial agreements were reached between the states and the railroads, Congress passed a series of acts authorizing the federal government to pay the states' share of the construction costs of these facilities. Section 204 of the National Industrial Recovery Act, 48 Stat. 195, 203 (1933), provided that the government would reimburse the states for:

> all or any part of the cost of * * * the elimination of hazards to highway traffic, such as the separation of grades at crossing, the reconstruction of existing railroad grade crossing structures, the relocation of highways to eliminate railroad crossings, * * * the construction of facilities to improve accessibility and the free flow of traffic, and the cost of any other construction that will provide safer traffic facilities or definitely eliminate existing hazards to pedestrian or vehicular traffic. * * *

In the ensuing years frequent disputes arose between the governmental bodies and the railroads over the railroads' unwillingness to share in the construction costs of the facilities. In order to settle these disputes, Congress passed the Federal-Aid Highway Act of 1944, 58 Stat. 838, Sec. 5 (a) and (b), which authorized the federal government to reimburse the states for the entire cost of highway-railroad crossing projects (other than rights-of-way), subject only to the limitation that if the railroad received benefit from the constructed facility, it should reimburse the government on a pro rata basis. In no event could the railroad's benefit be deemed more than 10 percent of the cost of the project (see App., *infra*, pp. 47a–48a).

Most of the agreements between respondent and the contracting states do not indicate whether respondent or the state has title to the constructed facilities. Under the agreements, however, respondent is required to maintain the facilities directly related to railroad vehicle use, such as bridges, roadbeds, and tracks, while the states are required to maintain the facilities directly related to motor vehicle use, such as highways and approaches (App., *infra*, p. 56a). Although finding 8(b) of the court below indicates that respondent was obligated under all of its agreements to replace the original equipment when damaged or worn out, the agreements themselves do not appear to support this finding, and, in any event, it appears doubtful that the replacement obligation applies to many types of facilities. (Compare App., *infra*, pp. 48a and 56a.)[2]

As the court below found (App., *infra*, p. 57a), these facilities were constructed "primarily for the benefit of the public to improve safety and to expedite highway traffic flow."[3] The allocation of funds set forth in the agreements between respondents and the states was based primarily upon factors such as accident statistics at the crossing points and the need for improved motor vehicle traffic flow. The agreements gave no consideration to the financial condition or

---

[2] Moreover, Section 204(a)(1) of the National Industrial Recovery Act, *supra*, and Sections 1 and 5(a) of the Federal-Aid Highway Act of 1944, specifically authorize federal payment for reconstruction of railroad grade crossing structures.

[3] Respondent did, however, receive benefit from the facilities, including probable lower accident rates, reduced operating expenses at crossings, and in some instances higher train speed limits (see App., *infra*, p. 57a).

need for capital of respondent and the other railroads (App., *infra,* p. 57a).

The aggregate cost of the facilities paid out of public funds with respect to which respondent now seeks to take depreciation was $2,146,140, of which $1,538,543, or 71 percent, represented highway undercrossings or overcrossings, $548,877, or 26 percent, crossing signals, signs and floodlights, and $58,721 jetties and bridges (App., *infra,* p. 55a).

In this suit, brought in the Court of Claims, respondent alleged that it overpaid its 1955 income tax when it failed to take deductions for depreciation with respect to the cost of the crossing facilities paid for out of public funds. The Court of Claims held, with three judges dissenting, that respondent was entitled to include in its depreciation basis the entire $2,146,140 paid for or reimbursed out of public funds and to take deductions therefor. The majority, relying on the decision of this Court in *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583, reasoned that even though the governmental payments were not intended to be contributions to respondent's capital, but rather, to absorb part of the cost of building public highway systems, the facilities in question did, in fact, enlarge respondent's working capital and produce economic benefits for respondent; therefore the facilities were depreciable under Section 113(a)(8)(B) of the Internal Revenue Code of 1939, which prescribes a carryover of the transferor's basis for property acquired by a corporation as a contribution to its capital.

Judge Davis, writing for the three dissenting justices, noted that under the test set forth in *Brown Shoe,* there is no contribution to a corporation's capital and, correspondingly, no depreciable basis under Section 113(a)(8)(B), unless the property in question is transferred with a donative purpose or intent. Here, the dissent reasoned, the states and the federal government paid for the highway-railroad crossing facilities not in order to confer a benefit or gratuity on respondent, but solely in order to expedite the flow of traffic and improve public safety at crossings. Consequently, the instant case is governed not by *Brown Shoe,* but instead by the Court's decision in *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98, in which the Court held that there was no depreciable basis with respect to property paid for by customers of a taxpayer-utility company as a prerequisite to receiving the company's services.

The dissent also noted that as a condition to being permitted to change its method of depreciation accounting for road property from the retirement method to the ratable depreciation method in 1943, the respondent, in common with other railroads, had agreed in a "terms letter" to exclude this "donated" property from its depreciable base (App., *infra,* p. 49a). The majority held that the terms letter was not binding on taxpayer in this regard (App., *infra,* pp. 8a–10a).

REASONS FOR GRANTING THE WRIT

The decision below, which incorrectly allows respondent to take depreciation on assets paid for by governmental bodies solely for the purpose of expedit-

ing highway traffic and improving safety at grade crossings, is in conflict with decisions of this Court. If allowed to stand, the decision will allow a tax benefit for sums never expended by the taxpayers, will affect many railroad taxpayers, and will have a severe adverse impact on the revenues.

1. The purpose of the depreciation allowance is to allow a taxpayer to deduct from his taxable income the portion of his investment in certain capital assets which may have been used up in earning that income. *United States* v. *Ludey,* 274 U.S. 295, 300; *Massey Motors, Inc.* v. *United States*, 364 U.S. 92; *Fribourg Navigation Co.* v. *Commissioner,* 383 U.S. 272. To that end, Sections 167 (a) and (g), 1011 and 1012 of the Internal Revenue Code of 1954, *supra,* in combination, provide that the basis on which depreciation is allowed with respect to any property is the cost of that property to the taxpayer, adjusted to reflect prior depreciation. The depreciation deduction is designed to reflect approximately the portion of a taxpayer's expense incurred in the purchase of an asset which is attributable to the production of income in any particular year. If a taxpayer has made no investment in an asset, so that its gradual consumption represents no actual expense to him, the reason for allowing depreciation does not apply, any more than the rationale for an expense deduction would apply to a taxpayer who had incurred no expense.

The Internal Revenue Code of 1939 provided a limited exception to the general rule that a taxpayer can only depreciate its cost basis in an asset. Section 113

(a)(8) of the 1939 Code[4] allowed corporate taxpayers to take depreciation on property acquired after 1920 either (a) in exchange for stock from controlling stockholders, or (b) as paid-in surplus or as a contribution to capital, in which event the transferor's basis was to be carried over.

This Court has twice considered the meaning of the term "contribution to capital" as used in Section 113 (a)(8)(B) of the 1939 Code. In both cases, the Court tested the assets on which taxpayers claimed depreciation in terms of whether the transferor had a donative intent to increase, or "contribute" to, the capital of the transferee corporation. In *Detroit Edison Co.* v. *Commissioner, supra,* 319 U.S. at 102, the Court denied depreciation with respect to certain power lines for which taxpayer's customers had paid in order to make their homes accessible to the taxpayer-utility company's services. The Court stated that "It * * * overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company."

In *Brown Shoe Co.* v. *Commissioner, supra,* the taxpayer sought to depreciate assets which had been contributed to it by private citizen groups who intended to induce taxpayer to locate a new plant in their community. In holding that the properties in question had been contributed to taxpayer's capital within the meaning of Section 113(a)(8)(B), the Court noted

---

[4] The Internal Revenue Code of 1954 allows taxpayers to continue to take the depreciation allowed by Section 113(a) (8)(B) with respect to property acquired prior to June 22, 1954. See Sections 362(a) and 1052(c) of the 1954 Code.

that the citizen groups had a "different purpose" from that of the taxpayer's customers in *Detroit Edison*. As the Court noted, the citizen groups "neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large." "Under these circumstances," the Court concluded, "the transfers manifested a definite purpose to enlarge the working capital of the company." 339 U.S. at 591.[5]

The Court of Claims specifically found that "The facilities * * * were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow" (App., *infra*, p. 57a). In holding, despite this finding, that the state and federal governments contributed the facilities at issue here to respondent's capital, the court has rejected the test for a contribution to capital set forth by this Court in *Detroit Edison* and *Brown Shoe*. Although the facilities with respect to which respondent claims depreciation were of some incremental value to it, they were largely incidental to the operation of respondent's railroad business, and were certainly not paid for by the states and the federal government for the purpose of expanding respondent's capital. As

[5] In neither *Detroit Edison* nor *Brown Shoe* was there any dispute that the property was exhaustible or that it was used for the economic benefit of the transferee in its business. Nor was there any inference that the taxpayer did not have the burden of maintaining and replacing the property in the future, see *infra*, pp. 14–15. The only distinction between the cases was in the purpose of the transferors.

Judge Davis argued persuasively in his dissent (App. *infra*, p. 47a):

> In this instance, it is evident to me that Congress, which funded all or the lion's share of the "donations" as part of the federal highway program, did not have in mind awarding any substantial gratuities to the railroads or increasing their capital. The intended beneficiaries of the program, ultimate and immediate, were the people at large, the auto-travelling segment of the public, and the trucking industry. * * * The benefits to the railroads were small, indirect, and merely incidental—not, as in *Brown Shoe*, large, direct, intended, and immediate. The highway program was certainly not undertaken in order to give free aid to the railroads. What they may have gained was no more than a minor by-product of the overriding aim of Congress (and the states) to reach very different goals. The physical assets left with the railroads were not central to their business, as in *Brown Shoe* and *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, 643 (C.A. 3, 1949), but were peripheral and tangential. That the railroads were to receive these items was not the prime and significant purpose of the Federal Government or the states, but a casual consequence, as it were, of the highway program which had other ends.[6]

[6] That the governmental bodies lacked a donative intent in the construction of these facilities is confirmed by this Court's opinion in *Nashville, Chattanooga & St. Louis Ry.* v. *Walters*, 294 U.S. 405, 421, 427. The issue in that case was whether it was reasonable for a state to impose upon the Railway company 50 percent of the cost of highway overpasses and underpasses at rail crossings constructed as part of the Federal-Aid Highway program. The Court held that the Supreme Court of Tennessee erred in failing to give weight to the Railway's evidence

Indeed, as Judge Davis also noted (App., *infra*, pp. 47a–48a), the lack of intent to make a contribution of capital to the railroads is clearly reflected in the Federal-Aid Highway Act of 1944, 58 Stat. 838, Section 5(a) and (b), which requires the railroads to pay that portion of the cost of these facilities which reflects their economic benefit therefrom.

The Court of Claims appears to have based its conclusion that this case is analagous to *Brown Shoe* in part upon the fact that in both cases the assets in question were paid for in order to benefit the public at large. The decision of this Court in *Brown Shoe,* however, was not based upon the intention of the donor-citizen groups to benefit the public at large, but rather upon the fact that these groups intended to encourage the taxpayer to locate its plant in the donor's community by making an unrestricted contribution to the taxpayer's property—property which it fully owned and controlled. Here, as the majority of the Court of Claims acknowledged, the governmental bodies which paid for the facilities which respondent now claims as depreciable assets narrowly restricted expenditures to the construction of the projects they felt were beneficial to the public interest. These projects were only of incidental benefit to respondent. Indeed, by facilitating automobile, bus, and truck traffic they stimulated the railroads' competition. They could not be deemed to have expanded respondent's capital to any substantial extent

---

that the requirement was unreasonable on the ground that the program was for the benefit of the public at large and particularly drivers of motor vehicles, not for the Railway.

and were not intended to do so. Their obvious purpose was to contribute to the expedited flow of highway traffic and public safety while leaving the railroads free to operate as they had been doing before the development of road traffic. As both *Detroit Edison* and *Brown Shoe* imply, a benefit of this sort, not fundamentally designed to enhance the railroads' assets, does not turn a public expenditure into a contribution to respondent's corporate capital.

In support of its holding that respondent was entitled to depreciate the facilities in question, the majority of the court below also emphasized its conclusion that respondent was obligated to maintain, repair, and replace worn out and destroyed facilities. Even if this conclusion is supported in the record, which we believe it is not, see *supra,* p. 6, the obligation to replace the assets paid for by the governmental bodies has no bearing on respondent's right to take depreciation with respect to these assets. As this Court has frequently held,[7] depreciation is an allowance for the exhaustion of an existing investment; there is no depreciation allowance for a future investment, regardless of how probable it is that the investment will be made. If respondent incurs maintenance and repair costs with respect to these facilities in the future, it can deduct these expenses as they occur. If respondent replaces facilities as they become worn

---

[7] See, *e.g.*, *Weiss* v. *Wiener*, 279 U.S. 333; *Helvering* v. *Lazarus & Co.*, 308 U.S. 252; *Detroit Edison Co.* v. *Commissioner*, *supra.*

out, it can include the assets which it pays for in its depreciable base at that time.

Respondent seeks here to take a depreciation deduction with respect to assets in which it has no investment and which it has received free of income tax liability as well as free of cost. To permit the depreciation deduction which respondent seeks would impute to Congress the intent to pay twice for the railroad-highway crossing projects constructed at the site of respondent's railroad—once as a part of the Federal-Aid Highway program, and once again, to the extent of approximately 50 percent of the cost of the projects, through deductions from respondent's taxable income. To expand in this manner Section 113's narrow exception to the rule limiting depreciation to taxpayer's cost basis is inconsistent with the entire rationale of the depreciation deduction and is in conflict with the decisions of this Court.

2. The resolution of the issue in this case is of substantial significance to the revenues. From 1934 through the fiscal year ended in 1954,[8] $623,000,000 in federal funds were paid out for projects and improvements at railroad-highway grade crossings.[9] In addition there were substantial expenditures of state

---

[8] Under Section 362 of the Internal Revenue Code of 1954, property acquired by a corporation from a non-shareholder as a contribution to capital after June 22, 1954, has a zero basis, and consequently, cannot give rise to depreciation deductions.

[9] Statistical Report of United States Department of Transportation, Federal Highway Administration, on Railway-Highway Grade Crossing Elimination, Reconstruction and Protection Projects in which Federal Funds Have Participated in Whole or in Part, November 16, 1971 (unpublished).

funds for these purposes, at least until 1944. There were also substantial governmental grants during that period to utility companies, primarily designed to enable those companies to relocate their lines in order to accommodate improvements to the national highway system.[10] The Internal Revenue Service believes that the depreciability f most of this property, the largest block of which was constructed in the years immediately before 1954, is still litigable within the available period of limitations or for future years. It is difficult to determine precisely how much revenue is at stake; the Commissioner estimates, however, that depreciation on property with a cost basis of between $500,000,000 and $1,000,000,000 is dependent upon the resolution of this issue.

In addition to the instant case, the same issue is present in at least six other cases now pending in the Court of Claims, two of which have been brought since the decision herein,[11] two cases in the district

---

[10] Personnel of the Federal Power Commission, the Internal Revenue Service, and the Federal Communications Commission believe that the governmental grants to utilities in connection with highway relocations and expansions were significant, but neither the utility companies nor the governmental agencies have hitherto had occasion to segregate the governmental grants from other contributions in aid of construction.

[11] *Union Pacific Railroad Co.* v. *United States*, Ct. Cl. No. 310–62; *Texas and Pacific Railway Co.* v. *United States*, Ct. Cl. No. 111–70; *Southern Railway Co.* v. *United States*, Ct. Cl. No. 19–72; *Chicago, Burlington & Quincy Railroad Co.* v. *United States*, Ct. Cl. No. 164–65; *New Orleans Terminal Co.* v. *United States*, Ct. Cl. No. 266–72; *Baltimore and Ohio Railroad Co.* v. *United States*, Ct. Cl. No. 269–72.

courts,[12] two in the Tax Court,[13] and in at least twelve cases pending administratively in the Internal Revenue Service. The Service believes that many railroads and utility companies which have filed their returns on the assumption that they were not entitled to depreciation on this property (as did the respondent herein) will now begin claiming depreciation on the basis of the decision below. Because the useful life of these facilities is frequently as long as fifty or sixty years, the issue in this case will remain relevant for many more years, even though the 1954 Code eliminated the practice of taking depreciation on non-shareholder contributions to capital[14] made after June 22, 1954.

3. Although the Court of Claims is the first court to rule on the depreciability of these safety facilities, so that there is no present conflict of circuits, it is not feasible to await the development of such a con-

---

[12] *Chicago, Burlington & Quincy Railroad Co.* v. *United States*, Civil Action No. 65–C–751 (N.D. Ill.); *United States* v. *St. Louis-San Francisco Railway Co.*, Civil Action No. 71–C–666(1) (E.D. Mo.).

[13] *Chesapeake and Ohio Railway Co.* v. *Commissioner*, T. C. Docket No. 5846–71; *Louisville & Nashville Railroad Co.*, Docket Nos. 4614–67 and 5384–67.

[14] Indeed, in spite of the attribution of a zero basis to non-shareholder contributions to capital, the proper meaning of the term "contribution to capital" remains a matter of importance under the 1954 Code. Section 118 of the present Code, for example, provides that corporations may exclude from gross income property transferred to them as contributions to capital. Under this provision, the instant case would raise the question whether the facilities paid for by governmental agencies would be entirely excludable from respondent's gross income, or whether the construction of these facilities would, to the extent of benefit resulting to respondent, constitute taxable gross income.

flict. On the basis of past experience with issues decided in taxpayers' favor in the Court of Claims, it is likely in the future that taxpayers who have substantial tax liability contingent on this issue will bring their suits in that court, which has a national jurisdiction. Indeed, it is reasonable to expect that the railroad companies whose cases are now pending in two district courts and the Tax Court,[15] one of which is the respondent in this case, will either dismiss and refile in the Court of Claims or abandon their claims for the years in issue rather than risk a conflict that would prejudice their tax situation for many years in the future.

4. If the Court decides to resolve the substantive depreciation issue presented in this case, we submit that the Court ought also to consider the holding of the court below that the terms letter agreement between respondent (along with other railroad companies) and the Internal Revenue Service is not binding on the railroads with respect to the issue in this case. The railroads entered into this agreement as a condition for being permitted to change over from retirement accounting to ratable depreciation, which was designed to ameliorate the effect of low retirements in the face of high income during World War II.[16] See *Chicago, Milwaukee, St. Paul & Pacific Rail-*

---

[15] See *supra*, p. 17, notes 12 and 13.

[16] Treasury Regulations 111 under the Internal Revenue Code of 1939, Section 29.41–2, provides that a taxpayer who changes his method of accounting must secure the consent of the Commissioner. Section 446(e) of the 1954 Code carries over the substance of this provision.

road Co. v. *United States,* 186 Ct. Cl. 250, 267, 404 F. 2d 960, 969; App., *infra,* pp. 57a–58a. The agreement has, in effect, been ratified by Congress in the Retirement-Straight Line Adjustment Act of 1958 (Sec. 94 of the Technical Amendments Act of 1958, P. L. No. 85–866, 72 Stat. 1606, 1669). The majority below reasoned that the conditions of this agreement were mere opinions of the Internal Revenue Service, and that the respondent's agreement to the terms is not binding on it because respondent may only have "acquiesced in the condition, without agreeing with it, simply to avoid possible refusal of its requested change in accounting methods" (App., *infra,* p. 10a). The court also suggested that this Court's decision in *Brown Shoe, supra,* provides a change in the law sufficient to avoid the express terms of the agreement. The Court's refusal to recognize the binding nature of this letter, has, in our view, no basis in law, and raises new uncertainties previously thought to have been settled with respect to the depreciation practices of virtually all railroads. See *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* v. *United States, supra.*

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
FRED B. UGAST,
Acting Assistant Attorney General.
RICHARD B. STONE,
Assistant to the Solicitor General.
PHILIP R. MILLER,
Attorney,
Department of Justice,
Washington, D.C. 20530.

In the United States Court of Claims

No. 149-65

(Decided February 18, 1972)

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY v. THE UNITED STATES

Richard J. Schreiber, for plaintiff. *Robert T. Molloy*, attorney of record. *Richard J. Cubbage*, of counsel.

Frances Foltz, *Philip Miller*, *Joseph Korner*, and *Mildred L. Seidman*, with whom was *Assistant Attorney General Johnnie M. Walters*, for defendant. *Gilbert W. Rubloff* and *David J. Gullen*, of counsel.

Before COWEN, *Chief Judge*, LARAMORE and DURFEE, *Senior Judges*, DAVIS, COLLINS, SKELTON, and NICHOLS, *Judges*.

OPINION

PER CURIAM: This case was referred to Trial Commissioner James F. Davis with directions to make findings of fact and recommendation for conclusions of law under the order of reference and Rule 134(h). The commissioner has done so in an opinion and report filed on October 28, 1970. The plaintiff filed exceptions to the commissioner's opinion with respect to the rail salvage issue and the vacation pay accrual issue. The defendant filed exceptions to the commissioner's opinion regarding the issues of donated property depreciation, casualty loss, welded rail, protective facilities, and the Mexican tax credit. Both parties requested review of the commissioner's opinion. The case has been submitted

to the court on oral argument of counsel and the briefs of the parties. Since the court agrees with the commissioner's opinion, findings of fact and recommended conclusion of law, with certain modifications, as hereinafter set forth, it hereby adopts the same, as modified, as the basis for its judgment in this case.* Therefore, it is concluded the plaintiff is entitled to recover, together with interest as provided by law, on the claims relating to (1) § 1341 computation, (2) excess salvage value, (3) donated property depreciation, (4) casualty loss, (5) welded rail, (6) protective work, and (7) Mexican tax credit, and judgment is entered to that effect. The court further concludes that plaintiff's recovery shall be subject to the setoffs raised by defendant with respect to (1) rail salvage value, and (2) vacation pay accrual. The amount of recovery will be determined in subsequent proceedings under Rule 131(c).

Commissioner DAVIS' opinion, as modified by the court, is as follows:

This is a suit to recover income taxes paid for the year 1955. Plaintiff operates a railroad as a common carrier in interstate commerce, subject to the jurisdiction of the Interstate Commerce Commission. Plaintiff's petition raised six issues with respect to a claim for refund timely filed with, and ultimately denied by, the District Director of Internal Revenue at Chicago, Illinois. In its answer and first amended answer, defendant asserted four setoff defenses, pursuant to *Missouri Pacific R.R.* v. *United States*, 168 Ct. Cl. 86, 338 F. 2d 668 (1964). Before trial, defendant dropped one of the setoff defenses; and by pretrial stipulation, the parties resolved one issue raised in the petition.[1] Trial was held on the remaining eight issues. After trial, defendant conceded that plaintiff is entitled to recover

---

*The dissenting opinion of DAVIS, *Judge*, in which LARAMORE, *Senior Judge*, and DURFEE, *Senior Judge*, join in part, and in which NICHOLS, *Judge*, joins, and the dissenting opinion of NICHOLS, *Judge*, follow the opinion of the trial commissioner which has been adopted by the court.

[1] The setoff defense dropped and the issue resolved by pretrial stipulation both relate to the so-called § 1341 computation issue. The parties agreed that the "amount of $490,315.14 may be accepted as the correct over payment under this issue." Accordingly, neither party submitted proposed findings of fact or briefs on such issue.

on one other issue raised in the petition.[2] Remaining for resolution, therefore, are seven issues, designated as follows: (a) donated property depreciation; (b) casualty loss; (c) welded rail; (d) rail salvage value; (e) protective work; (f) vacation pay accrual; and (g) Mexican tax credit.

Donated Property Depreciation Issue

Starting about 1930, plaintiff entered into many agreements with several midwestern states for construction of highway overpasses and underpasses at highway-railroad intersections, and grade-crossing protection equipment, such as flashing-light signals and automatic gates. Though the agreements are not identical, generally plaintiff agreed to perform a large share of the construction work and the states agreed to pay most of the cost. Sometimes, part of the work was done by state highway departments. Pursuant to Federal highway aid legislation (particularly acts passed in 1933 and 1944), the Federal Government agreed to pay the governmental share of the cost. Federal funds were allocated to the states to pay for specific construction projects. *E.g.*, the Federal Highway Act of 1944, 58 Stat. 839, ch. 626, provided that costs be apportioned between the Government and the railroads, the railroads' share not to exceed 10 percent.

Most of the agreements did not state expressly whether the respective state governments or plaintiff was to have legal title to the facilities. However, the parties have stipulated that the facilities (jetties, bridges, highway undercrossings and overcrossings, floodlights, flasher signals, and signs) were "contributed" to plaintiff by the states; and this is taken to mean that plaintiff owns them, at least for purposes here material. *See Lazarus, infra.* In any event, under all the agreements, plaintiff was obligated to maintain and replace as necessary, at its own expense, facilities originally built. The facilities were constructed primarily for the benefit of the public to improve safety and to expedite motor-vehicle traffic flow. The record shows, however, that plaintiff received eco-

---

[2] Defendant says in its brief that plaintiff "is entitled to the recovery claimed under * * * [the excess salvage] issue." Thus, no findings on, or discussion of, that issue are required.

nomic benefits from the facilities, *e.g.*, probable lower accident rates, reduced expenses of operating crossing equipment and, where permitted, higher train speed limits. Plaintiff also received intangible benefits, *e.g.*, goodwill from the community-at-large, which was to plaintiff's long-term economic advantage.

On February 5, 1943, plaintiff requested permission of the Service to change from retirement to depreciation accounting for road property. On April 23, 1943, the Service responded by letter to plaintiff's request and enclosed Mimeo 58, entitled "Change from Retirement to Depreciation Accounting for Road Property." Mimeo 58 set out guidelines under which the changeover in accounting practice by the railroads would be acceptable to the Service and described information to be furnished by the railroads. Plaintiff thereafter furnished to the Service the required information which, in essence, constituted a list of properties subject to depreciation, their cost basis, salvage value, expired life, and estimated normal useful life. On September 20, 1944, the Service sent plaintiff a terms letter, incorporating the information supplied by plaintiff and some of the requirements set out in Mimeo 58. This terms letter was reaffirmed by defendant's letter of December 14, 1959. The terms letter granted plaintiff permission "to change from retirement to depreciation accounting as of January 1, 1943," to be effective "upon receipt of a letter agreeing to all the terms and conditions set forth herein." On April 20, 1945, plaintiff accepted the terms letter on the condition that "in the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise," plaintiff would not be precluded "from the benefits of any such changes" and would be "entitled to the benefits of any such changes regardless of the acceptance herein contained."

Mimeo 58 provided in part that "Donated property or contributions or grants in aid of construction from any source must be excluded" from the depreciable base. This statement was not included in the terms letter. However, the schedules of plaintiff's property, submitted to the Service for which straight line depreciation was requested, did not include the donated property here at issue.

Subsequently, on May 1, 1961, plaintiff submitted to the Service revised schedules for depreciable roadway property and requested the benefit of section 94 of the Retirement-Straight Line Adjustment Act of 1958. The Service responded to plaintiff's request, noting the terms letter of September 20, 1944, and stating that plaintiff's revised schedules were acceptable so far as relevant herein. The revised schedules of depreciable property submitted by plaintiff to the Service in 1961 did not include the donated property here at issue.

The issue is whether the facilities are assets properly depreciable by plaintiff. Plaintiff contends they are property donated to it for use in its business and are depreciable under the rationale of *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583 (1950). Defendant concedes that the facilities are of a character normally subject to allowance for depreciation and that to the extent they were paid for by plaintiff, appropriate depreciation deductions are proper. Defendant says, however, that to the extent plaintiff did not pay for the facilities, it cannot depreciate them, relying on *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943). The parties have agreed to the adjusted tax basis for the facilities in the hands of the plaintiff at the time of acquisition, and the rate of straight-line depreciation applicable, if the court decides that depreciation on the full value is proper. The parties have also agreed that the issue is whether the law of *Detroit Edison* or *Brown Shoe* is applicable. Our starting point therefore is a brief discussion of the *Detroit Edison* and *Brown Shoe* cases.[3]

In *Detroit Edison*, the issue was whether the taxpayer could depreciate the cost of certain electric power lines. The taxpayer, Detroit Edison Company, engaged in the generation of electric power for distribution and sale to the public. It often received applications for service which, in its opinion, would require the construction of power line extensions having a cost not warranted by prospective revenues. Accordingly, the company required the applicants for service to pay the cost of line installations, in part refundable

[3] For excellent and detailed analyses of *Detroit Edison* and *Brown Shoe*, as well as related cases, see Freeman and Speller, *Tax Consequences of Subsidies to Induce Business Location*, 9 TAX L.R. 255 (1953–54); also, Note *Tax Consequences of Non-Shareholder Contributions to Corporate Capital*, 66 YALE L.J. 1085 (1956–57).

from future revenues collected. The company contended that, to the extent the cost of the lines was not refunded, the customers' payments were gifts or contributions to the company's capital and thus were depreciable to it as exhaustible capital assets. The Court held, however, that the payments were not gifts or contributions to the company's capital but rather were payments for "the price of the service," *i.e.*, the providing by the company of electrical power to the customers. The Court said "[i]t is enough to say that it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company." Thus, the taxpayer was not permitted the depreciation deductions it sought.

In *Brown Shoe*, decided seven years after *Detroit Edison*, the issue was whether property, including buildings and equipment, donated to the taxpayer by community groups, represented "contributions to capital" and were depreciable within the meaning of § 113(a)(8)(B) of the Internal Revenue Code (1939). The property was donated to induce the taxpayer to set up and operate a manufacturing plant in the community. The Court held that the property constituted capital assets in the hands of the taxpayer and was depreciable by it, noting that the "values which the taxpayer received were additions to 'capital' as that term has commonly been understood in both business and accounting practice," and that "contributions to capital may originate with persons having no proprietary interest in the business." The Court further noted, citing *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, 643 (3d Cir. 1949), that "* * * the assets received * * * are being used by the taxpayer in the operation of its business, * * * will in time wear out, and * * * must eventually be replaced." Finally, the Court said, in distinguishing the *Detroit Edison* case, that the "contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. Under these circumstances the transfers manifested a definite purpose to enlarge the working capital of the company."

Plaintiff says that the facts here fit *Brown Shoe* rather than *Detroit Edison*. Plaintiff notes, among other things, that the facilities in issue are exhaustible assets used in plaintiff's business, are of a character normally subject to depreciation allowance, and were contributed to plaintiff by state governments whose interest was not to obtain goods or services but rather to benefit the public as a whole. Plaintiff also notes, citing *Edwards* v. *Cuba R.R.*, 268 U.S. 628, 633 (1925), that the facilities were contributed "unquestionably * * * to increase the capital position of the plaintiff taxpayer for only capital assets were contributed and not monies which could be used for the payment of dividends or expenses ordinarily payable out of earnings or income." The court concludes that the plaintiff is correct; and although the facts are not on all-fours with *Brown Shoe*, the rationale of that case, rather than *Detroit Edison*, is controlling.[4]

Defendant says that plaintiff "has no cost for these facilities and therefore does not stand to lose any portion of *its* investment by their use or the passage of time * * *." Plainly, there is no merit to this argument. In *Brown Shoe*, the taxpayer had no "cost" in the donated property; yet the property was held to be assets depreciable by the taxpayer. Defendant also says that the governmental payments for the facilities "were not intended to be contributions to the capital of the railroad," but rather were "part of the cost of the state in building *its* highway system"; and that the facilities are "not related to the production of income but rather to the safety of the local community." No doubt, the principal purpose of the facilities was to benefit the community-at-large by providing improved safety at railroad-highway intersections. But the fact remains that the facilities enlarged plaintiff's working capital and were used by plaintiff in its business; and though they may not produce income to the same extent as other railroad property, such as track or freight cars, plaintiff derived economic benefits from them.

Of principal importance, under every contract for constructing the facilities, plaintiff was obligated to maintain

---

[4] It has been suggested that *Brown Shoe* "in effect" overruled *Detroit Edison*. See the Freeman and Speiller article cited in n. 3, at 262. In any event, *Detroit Edison* does not apply here.

and replace the facilities at its own expense. This obligation places squarely on plaintiff the economic loss attendant to wear and tear of the property. As noted in the *McKay Products* case, *supra*, at 643, cited in *Brown Shoe*,

> * * * the assets * * * are being used by the taxpayer in the operation of its business. They will in time wear out * * * and must eventually be replaced. Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions * * * would seem to envision allowance of a depreciation deduction in situations like this * * *.

Also pertinent is *Helvering* v. *F. & R. Lazarus & Co.*, 308 U.S. 252 (1939), and cases cited therein, which holds that depreciation deductions go to the party which "bears the burden of wear and exhaustion of business property," irrespective of who may have legal title.

Defendant contends alternatively that, in accordance with the requirements of Mimeo 58 and the terms letter, plaintiff submitted schedules of its depreciable property which excluded the donated property here at issue from basis. The Commissioner of Internal Revenue accepted plaintiff's proposed basis for its depreciable road property and permitted plaintiff to make the requested accounting change. Included in the terms letter were the amounts to be included in the cost basis of plaintiff's various road accounts, together with the proviso that "the remaining sum to be recovered through depreciation allowances shall be limited to the cost or other basis less the depreciation so accrued * * *." Thus, says defendant, plaintiff agreed not to take any depreciation deductions based upon donated property.

Defendant also argues that the Retirement-Straight Line Adjustment Act of 1958 provides in section 94(e) that the terms and conditions of the terms letter would be binding on taxpayers such as plaintiff electing the benefits of that Act from the date of the terms letter until the date of such election.

Mimeo 58 provides in relevant part that:

> The basis for depreciation shall be the cost of the existing depreciable property to the present taxpayer, determined in accordance with sections 113 and 114(a) of the Internal Revenue Code. * * *.

*   *   *   *   *

The basis may include only the investment in property which is actually depreciable. Thus excavations, dredging, expendable small tools, land improvements, land surveys, etc., are not depreciable expenditures, whereas retaining walls, drainage systems, etc., are. Donated property or contributions or grants in aid of construction from any source must be excluded.

* * * * *

In view of the fact that it will be impossible for the Bureau to make a detailed investigation of the depreciation basis, the permission letter includes a mutual understanding that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should subsequent investigation disclose errors of cost or valuation. * * *

The terms letter provides in relevant part:

It is mutually understood that this is an agreement in principle and that a detailed investigation of the depreciation basis has not been made by the Bureau, and that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should investigation disclose errors of cost or valuation. * * *

Defendant argues for too narrow an interpretation of Mimeo 58 and the terms letter. It seems clear that the purpose of the just-quoted provisions was to establish as the basis for depreciation of the road property the basis allowable under Sections 113 and 114(a) of the Internal Revenue Code of 1939. The statement "Donated property or contributions or grants in aid of construction from any source must be excluded" was only the opinion of the Service with respect to what constituted the basis allowable under the Code and does not rise to the level of a condition upon which permission to change depreciation methods would be granted.[5] Ultimately, the Supreme Court determined that opinion to be erroneous in the case of *Brown Shoe Co.* v. *Commissioner*, *supra*, and held that, pursuant to Section 113(a)(8)(B) of the 1939 Code, a taxpayer was entitled to include in its basis for depreciation certain donated property.

---

[5] Similarly, plaintiff's failure to include the donated property here at issue in the schedules of plaintiff's property for which straight line depreciation was requested and in the later revised schedules may reflect no more than plaintiff's apparent opinion at those times that such property was not depreciable.

Even assuming that the statement "Donated property or contributions or grants in aid of construction from any source must be excluded" was a condition for the changeover, the provision that the basis for depreciation was to be determined in accordance with the Code should take precedence and control. As indicated, the *Brown Shoe* case, *supra*, held that certain donated property could be included in the depreciable base under Section 113(a)(8)(B) of the 1939 Code.

Furthermore, the 1944 terms letter itself, which constitutes the only agreement between the parties, says nothing about excluding donated property from the basis of depreciable property. While it might be argued and inferred that plaintiff agreed by implication to such condition in the guidelines, it is just as reasonable to infer that plaintiff acquiesced in the condition, without agreeing with it, simply to avoid possible refusal of its requested change in accounting methods.

Also, assuming again that the above statement was a condition for the changeover, that condition must be viewed in light of the law as it existed when the condition was accepted. As stated in *Brown Shoe*, *supra*, at 589, 591, it was the position of the Service that *Detroit Edison Co.* v. *Commissioner*, *supra*, settled the question that donated property could not be added to the basis for depreciation. When plaintiff accepted the terms letter in 1945, its acceptance provided that "in the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise," plaintiff would not be precluded "from the benefits of any such changes" and would be "entitled to the benefit of any such changes regardless of the acceptance herein contained." The Supreme Court's decision in *Brown Shoe*, *supra*, distinguishing the case of *Detroit Edison*, *supra*, and holding that certain donated property could be added to the depreciable base, produced such a change in the conditions of the terms letter and plaintiff is entitled to the benefits thereof.[6]

In sum, the facilities in issue are exhaustible assets properly depreciable by plaintiff to the full extent of their value.

---

[6] In passing, it is noted that § 362(c)(1) of the 1954 Code effectively overruled the *Brown Shoe* case with respect to property contributed to a corporation by a nonshareholder after June 22, 1954. It provides that the basis of such property shall be zero. Since the property here in question was all contributed to plaintiff prior to June 22, 1954, § 362(c)(1) does not apply.

Casualty Loss Issue

In 1955, 13 freight cars owned by plaintiff were destroyed in accidents while on lines of other railroads. The cars were property used in plaintiff's business and were emergency facilities subject to rapid amortization (60 months) pursuant to § 124A of the 1939 Internal Revenue Code and § 168 of the 1954 Internal Revenue Code. The cars' cost to plaintiff was $76,007.30. At the time of the loss, amortization had accrued to the extent of $36,886.58, the adjusted basis for the cars thus being $39,120.72. As compensation for the loss, plaintiff received $83,186.35, a gain of $44,065.63 over the adjusted basis. The issue is the tax treatment to be accorded such gain.

Plaintiff says the gain should be taxed as a capital gain, pursuant to § 1231 of the 1954 Code which provides in pertinent part:

> If, during the taxable year, the recognized gains on *sales or exchanges* of property used in the trade or business, plus the recognized gains from the *compulsory or involuntary conversion* (as a result of destruction in whole or in part, theft or seizure, * * *) of property used in the trade or business * * * into other property or money, exceed the recognized losses * * *, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. * * * (Emphasis added.)

Defendant, on the other hand, says that the gain should be treated as ordinary income to the extent of the difference between the adjusted basis of the property under rapid amortization and what the adjusted basis would have been under normal depreciation. The parties have stipulated that under straight-line depreciation, the adjusted basis at the time of loss would have been $67,759.94. The difference in bases, therefore, is $28,639.22 ($67,759.94 less $39,120.72). Defendant relies on § 1238 of the 1954 Code which provides:

> Gain from the *sale or exchange* of property, to the extent that the adjusted basis of such property is less than its adjusted basis determined without regard to section 168 (relating to amortization deduction of emergency facilities), shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. (Emphasis added.)

The parties agree that plaintiff's gain resulted from involuntary conversion; that § 1231 applies to gains from "involuntary conversion" as well as "sales or exchanges"; but that § 1238 speaks only of gains from "sale or exchange." That would appear to end the matter in plaintiff's favor since it has long been held that an involuntary conversion is not a sale or exchange. *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U.S. 247 (1941). Defendant, however, says that § 1238 should be construed to include gains from involuntary conversions, as well as gains from sales or exchanges, because otherwise plaintiff will "be able to take this gain as a capital gain after having taken deductions against ordinary income for the 'rapid amortization' under § 168." Defendant points to two cases, *Towanda Textiles, Inc.* v. *United States*, 149 Ct. Cl. 123, 180 F. Supp. 373 (1960), and *Kent Mfg. Co.* v. *Commissioner*, 288 F. 2d 812 (4th Cir. 1961), in which § 337 of the 1954 Code, dealing with gains from sales or exchanges by corporations during liquidation, was construed to include gains from involuntary conversions. Defendant says § 1238 should be construed the same way. Despite an appealing logic to defendant's position, in my view it cannot prevail.

Section 1238 is brief, clear and unambiguous. It was derived substantially unchanged from § 117(g)(3) of the 1939 Code. The legislative history of § 117(g)(3), enacted as part of the Revenue Act of 1950, shows that it was intended as a recapture provision to tax as ordinary income gains made upon the voluntary disposition (sale or exchange) of emergency facilities entitled to rapid amortization, to the extent such amortization reduced the basis of the property below normal depreciation. The Congressional committee report [7] which discusses and explains § 117(g)(3) speaks only of voluntary conversions, *i.e.*, "sales" and "exchanges," and gives examples of each. Nothing is said about involuntary conversions. The pertinent Treasury Regulation (Treas. Reg. § 1.1238–1) likewise speaks only of "sales" and "exchanges." It is thus clear from the statute, the regulations and the legislative history that the purpose of § 117(g)(3) (and

[7] H.R. Rep. No. 3124, 81st Cong., 2d Sess. (1950–2 Cum. Bull. 580, 586). See also S. Rep. No. 2375, 81st Cong., 2d Sess. (1950–2 Cum. Bull. 483, 550).

later § 1238) was to prevent taxpayers who are entitled to the benefits of rapid amortization of emergency facilities from later disposing voluntarily of those facilities so to convert accelerated amortization deductions from ordinary income into capital gains. Nothing in the legislative history suggests that it was also Congress' purpose to treat gains from involuntary conversions the same way. There is nothing surprising in this since involuntary conversions (unlike sales or exchanges) by their very nature are not events whose timing can be arranged to make inequitable gains after having had the benefits of rapid amortization.

Furthermore, the very structure of the statute militates against defendant's position. Section 1231 speaks of gains from "sales or exchanges" *and* "involuntary conversion." Yet § 1238, which qualifies § 1231 and refers expressly to it, speaks only of gains from "sale or exchange." It therefore can hardly be inferred that Congress intended "sale or exchange" in § 1238 to include "involuntary conversion," particularly in light of well-established judicial precedent that an involuntary conversion is not a sale or exchange. *Flaccus, supra.*

Also pertinent to the construction of § 1238 and Congressional purpose for its enactment are §§ 1245 and 1250 of the 1954 Code, added in 1962 and 1964, respectively. Those sections are recapture provisions, akin to § 1238, but deal with gains made upon the disposition of depreciable property subject to normal depreciation, rather than rapid amortization. In general, §§ 1245 and 1250 provide that gains made upon the disposition of depreciable property, which gains exceed the adjusted basis of the property, shall be taxed as ordinary income rather than capital gains. Sections 1245 and 1250 both speak expressly of gains made upon "involuntary conversion," as well as "sale or exchange." The inference therefore is clear that when Congress intends recapture provisions to include gains from involuntary, as well as voluntary, dispositions, it so-provides. Section 1238 does not so-provide; and courts cannot rewrite tax laws, however appealing and logical it may be. *See F. W. Fitch Co. v. United States*, 323 U.S. 582 (1945), *Shakespeare Co. v. United States*, 189 Ct. Cl. 411. 419 F. 2d 839 (1969). *cert. denied*, 400 U.S. 820 (1970).

Towanda and *Kent*, relied on by defendant, dealt with § 337 of the 1954 Code and the problem of gain derived by a corporation from an involuntary conversion during a period of complete liquidation. Section 337 provides, among other things, that during the 12-month period after a corporation adopts a plan of complete liquidation, "* * * no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period." In both *Towanda* and *Kent*, property of corporations in liquidation was destroyed by fire, and insurance proceeds exceeded the basis of the destroyed property. The Government argued that the gain was taxable to the corporations because § 337 speaks only of gains from "sale or exchange," not involuntary conversion. Both courts held that the gain was not taxable to the corporation because the purpose of § 337 was to avoid double taxation for gains recognized during corporate liquidation, *i.e.*, taxation first to the corporation, then later to the distributee shareholders. This court said in *Towanda* at 128, 129, 180 F. Supp. at 376:

> The taxation of the gain derived from an involuntary conversion of the property into cash during liquidation is clearly contrary to the declared purpose of Congress in enacting the section [*i.e.*, § 337], which was to avoid double taxation incident to the liquidation of the corporation, by exempting the corporation from liability for gain derived from the disposition of its capital assets, irrespective of whether or not certain formalities had been observed. Literally, an involuntary conversion is not a sale, but what Congress had in mind was a conversion of a corporation's capital assets into cash, whether voluntary or involuntary, and the distribution of the cash to the stockholders. * * * The purpose was to exempt the corporation from liability for the tax and to collect the tax from the stockholders alone. This being true, we must hold, in order to carry out the clear purpose of Congress, that an involuntary conversion comes within the intent of Congress when it exempted the corporation from liability for a tax on the gain derived from a sale of its property in liquidation.

The court in *Kent* agreed with this court's reasoning in *Towanda*, noting that a purpose of § 337 was "to avoid double taxation."

Defendant invites this court to construe § 1238 similarly to the way § 337 was construed in *Towanda* and *Kent*. In my view, this should not be done simply because (a) *Towanda* and *Kent* dealt with a unique problem, *i.e.*, double taxation flowing from corporation liquidation, and § 337 was construed to carry out "the clear purpose of Congress" of avoiding double taxation, and (b) § 1238, its legislative history and the regulations are clear and unambiguous, and show no Congressional purpose to include gains from involuntary conversions as one of the exceptions to the application of § 1231.

In sum, the gain in question is taxable as a capital gain pursuant to § 1231 of the 1954 Code.

Welded Rail Issue and Rail Salvage Value Issue

These issues revolve around a method of accounting known as retirement-replacement-betterment accounting. Actually, retirement-replacement-betterment accounting is a shorthand term f r three separate but interrelated accounting schemes—retirement accounting, replacement accounting and betterment accounting—by which plaintiff and other railroads determine allowable depreciation for property in track accounts, particularly rail and joint materials (angle bars, bolts and washers). To understand the issues, it is necessary to discuss in some detail the theory and practice of retirement-replacement-betterment accounting.

Retirement accounting

Normally, in computing depreciation for an exhaustible asset, the cost (or other basis) of the asset, less its salvage value, is spread ratably over the asset's useful life; and through annual depreciation charges, the cost is recouped. This means that the asset's book value decreases from year to year as depreciation charges accumulate. Capital additions and improvements made to the asset from time to time during its service life are added to the book value and, in turn, are depreciated. The theory is that at the end of the asset's useful life, the accumulated depreciation charges plus salvage value will equal original cost.

Retirement accounting, however, works differently. Rather than making annual adjustments for depreciation, the asset is carried on the books at its full value (usually cost) during its useful life. Then, at the time of retirement from service, the book value, diminished by the asset's salvage value, is charged to current expense. Retirement accounting thus results in deferred depreciation for any given asset. However, over an extended period of time, the depreciation deductions taken under retirement accounting for all assets in the account should closely approximate conventional ratable depreciation methods. As stated in *Boston & Maine R.R.* v. *Commissioner*, 206 F. 2d 617, 619 (1st Cir. 1953):

> * * * the underlying theory of the retirement method is that the charges to expense on account of all the items retired or replaced in any particular year are taken as a rough equivalent of what would be a proper depreciation allowance for *all* the working assets of the company for that year. The assumption is that once the system is functioning normally and the retirements are staggered fairly regularly, the charges to expense on account of equipment wearing out or otherwise disappearing from service are spread out and stabilized, and hence will approximate the results under straight-line depreciation. * * *

Retirement accounting is used by the railroads for their track accounts principally because it simplifies the difficult bookkeeping problem of making annual depreciation adjustments for the large number of fungible assets in such accounts, *i.e.*, rail and joint materials, and because it complies with the accounting requirements of the Interstate Commerce Commission as set out in the Uniform System of Accounts for Railroad Companies.

Replacement accounting

Replacement accounting works hand-in-glove with retirement accounting. It arises when a retired asset, rather than simply being removed from service, is replaced by a like asset. From an accounting standpoint, a replacement transaction comprises two steps: the retirement of one asset and the addition (or replacement) of a like asset. Logically, the accounting treatment for such transaction should entail (a) charging off to current expense the book value of the retired

asset, diminished by its salvage value, and (b) capitalizing the cost of the added (or replacing) asset. So treated, the books would tend to reflect, over the life of the account, the current value of all assets in service. However, plaintiff does not handle replacement transactions in this fashion. Rather, it takes as a current expense the cost of replacement, diminished by the salvage value of the retired asset, and leaves on the books the value of the retired asset. The theory is that each replacement, when considered in the context of the account as a whole, is a minor transaction, akin to a repair, and should be currently expensed. The result is that, after many years, the composite book value of all assets in service is a residuum of original costs, increased or decreased, as the case may be, by additions and betterments, or retirements without replacement, made from time to time over the life of the account.

On reflection, it can be seen that over a long period of years of no price inflation, it makes no difference from an accounting and depreciation standpoint whether a replacement transaction is handled in one or the other of the two above-noted fashions. To illustrate, assume a section of rail having an original cost of $1,000 is retired after 40 years and is replaced by a like section of rail costing $1,000, and that the salvage value of the retired rail is $200. Under either above-described method of replacement accounting, the book value of the rail in service remains $1,000 and the current charge to expense (representing depreciation) is $800 ($1,000 less $200). In contrast, over a period of substantial price inflation, it makes considerable difference which of the two methods is used. To illustrate, assume the same facts as above except that the cost of replacement, due to price inflation, is $2,000 rather than $1,000. Now, if the accounting transaction is handled by the first method, the charge to operating expense is still $800 ($1,000 less $200), and the $2,000 cost of replacement is capitalized to become the new book value of the rail in service. On the other hand, under plaintiff's method, the $2,000 is currently expensed, less $200 salvage value for the retired rail, leaving a current charge (representing depreciation) of $1,800; and the book value of the rail in service remains $1,000.

Defendant has no quarrel with the way plaintiff chooses to handle replacement accounting.[8] It conforms to the Interstate Commerce Commission's requirements for accounting for road property; and, indeed, it is consistent with the theory of replacement accounting in that the cost of replacements of individual assets of a whole account are deemed minor and, for ease of accounting, are currently expensed. A dispute arises, however, over the salvage value to be assigned to rail picked up from service but not disposed of as scrap. This dispute is later discussed in detail.

Betterment accounting

Betterment accounting works hand-in-glove with replacement and retirement accounting. It arises in one of two situations: (a) when additional rail is laid where no rail before existed, or (b) where rail laid in replacement is of heavier weight, and thus "better," than rail being replaced. In the first situation, the current cost of laying additional rail is capitalized, and such cost thereafter remains on the books until the rail is retired. In the second situation, the cost of the "betterment" portion of the rail laid in replacement is capitalized, while the remainder of the cost, reduced by the salvage value of the replaced rail, is currently expensed. To illustrate, if a section of 80-pound rail[9] is replaced with 100-pound rail, the cost attributable to the extra 20 pounds is capitalized; and the remaining cost, diminished by the salvage value of the 80-pound rail picked up, is currently expensed. In this way, the cost of additions and improvements is added to the books and remains in the account until retirement.

Welded rail issue

In 1955, as part of a continuing program of track renewal, plaintiff replaced a number of 39-foot lengths of rail with 78-foot lengths of heavier-weight rail. The 39-foot lengths

---

[8] The Internal Revenue Service accepts replacement accounting, as well as retirement and betterment accounting, as proper methods for determining depreciation under § 167 of the 1954 Internal Revenue Code. However, replacement accounting has been criticized and was the subject of a Congressional study in 1957. See REPORT OF COMMITTEE ON GOVERNMENT OPERATIONS, H.R. REP. No. 1167, 85th Cong., 1st. Sess. (1957).

[9] *I.e.*, rail weighing 80 pounds per linear yard.

which were replaced were fastened together by angle bars and bolts as had been conventionally done in the railroad industry for many years. The new 78-foot lengths were made by welding together two standard 39-foot rails as purchased from steel mills. In turn, the 78-foot lengths were bolted together in the track structure. Thus, in making the renewals, plaintiff substituted two heavier-weight 39-foot lengths of rail having a welded joint for two lighter-weight 39-foot lengths of rail having a bolted joint. Plaintiff accounted for this transaction under the retirement-replacement-betterment method as follows: It charged to current expense the portion of the rail cost and welding cost attributable to the same weight as the rail which was replaced (replacement in kind); it capitalized the portion of the rail cost and welding cost attributable to the weight of the new rail greater than the replaced rail (betterment); and it charged to current expense the book value of the joint materials (angle bars, bolts and washers) which were replaced by the welded joints (retirement). The cost of making welded joints in 1955 was $155,748, of which $140,808 was charged to current expense and $14,940 was capitalized, in accordance with the pro rata apportionment above described.

The dispute between the parties is whether plaintiff properly accounted for the cost of welding. Defendant says plaintiff should have capitalized the entire welding cost ($155,748), rather than only part of it ($14,940), because a welded joint constitutes a "betterment" over a bolted joint within the context of retirement-replacement-betterment accounting. Defendant relies on Rev. Rul. 67–22, 1967–1 Cum. Bull. 52, which, in essence, holds that under retirement-replacement-betterment accounting, the cost of welded joints, whether laid with new rail or replacement rail, must be capitalized because "welding of rail creates something new or better by substitution or addition of different materials, reduces track renewal cost, prolongs rail and rolling stock life, reduces maintenance costs, and increases the value of the track structure." The Revenue Ruling notes § 263 of the Internal Revenue Code (1954) which provides in pertinent part that no deductions shall be allowed for "any amount paid out * * * for permanent improvements or

betterments made to increase the value of any property or estate * * *." Plaintiff, on the other hand, contends that under retirement-replacement-betterment accounting, the cost of welding should be currently expensed in full because "the cost of the weld is a part of the cost of the rail itself and should be accounted for on the same basis as is the rail * * *." Plaintiff also says that welded joints are not betterments over bolted joints because they do not increase the value of the track structure, do not prolong the life of the rail, and do not add new and improved materials to the track system.

Thus framed, it is important to point out that the issue is not whether the cost of replacing bolted joints with welded joints is a repair as opposed to a capital expenditure. The parties agree that the expense is capital in nature. The issue is simply whether welded joints, which replace bolted joints, are such an improvement or betterment to the track that their cost should be capitalized, rather than currently expensed, in accordance with the method of retirement-replacement-betterment accounting used by plaintiff. Defendant agrees that if bolted joints are replaced by bolted joints, the cost of the replacement, less the salvage value of the replaced materials, is chargeable to current expense. Defendant says simply that welded joints are so different from bolted joints and are such an improvement over bolted joints that their cost must be fully capitalized and not charged to current expense until the welded rail is retired or replaced by other welded rail.

The issue boils down to an analysis of the differences between bolted joints and welded joints, both from a cost and technology standpoint. Functionally, the joints do the same job—they hold together the ends of pieces of rail so to make a continuous track structure. Thus, welded joints which replace bolted joints add no new or different function to the rail system. Bolted joints comprise a pair of angle bars which bridge the rail ends across the rails' web and are fastened to the web by six bolts and washers. In 1955, it cost plaintiff about $10 to install a bolted joint, depending on the weight of the rail.[10] Bolted joints require maintenance from time to time since they tend to come loose with wear. The record

[10] Bolted joints for 112-pound rail cost $9.81 each; for 129-pound rail, $10.39.

shows that bolt tightening is required the first year after installation and generally each two years thereafter. After extensive use, the bolts and washers may need replacing.

Welded joints, in contrast to bolted joints, are made by fusing together the ends of the rail under intense heat. No material is added to the rail. Rather, about 7/8 inch is lost off each rail during the welding process because the rail ends are forced together under pressure, thus creating a bead of raised metal at the weld which must be ground down to make a smooth joint. In 1955, it cost plaintiff $11.83 to make a welded joint. Welded joints do not require maintenance like bolted joints; and in fact the record shows that during the first 12 years of service of welded rail (1955–1967), welded joints required no substantial maintenance at all. However, the record also shows that welded joints are not an unmixed blessing. About 1967, welded joints installed on plaintiff's main lines in 1955 exhibited serious wear and deterioration known as secondary batter. Secondary batter results from the fact that the fused metal at the weld is harder than the rail on either side of the weld. Thus, the joint wears less rapidly than the main rail. After extensive use and track wear, the metal adjacent either side of the weld tends to dish out as the wheels of railroad cars ride over the weld, *i.e.*, the wheels tend to batter the track downstream of the weld. Secondary batter becomes progressively worse with time and particularly if trains run both directions on the track. Though no maintenance to correct secondary batter was done by plaintiff between 1955 and 1967, the record shows that substantial maintenance will be required soon and that such maintenance will be necessary from time to time during the 40–50 year useful life of the rail. The maintenance will involve grinding down the track and weld to eliminate dished-out areas, or in extreme cases, cropping out the damaged areas and rewelding the rail ends.

Against these facts, it must be concluded that the record does not support defendant's position that welded joints vis-à-vis bolted joints constitute a "betterment" to the track system in terms of retirement-replacement-betterment accounting. From a purely monetary standpoint, the cost per welded joint is about the same as a bolted joint ($11.83 v.

about $10). Though this factor alone is not determinative of the "betterment" question, plaintiff's investment in welded joints is not substantially greater than if it had used all bolted joints, and thus shows that plaintiff has not made a substantial increase in monetary value in its track system. Defendant, however, points to other factors which it says show that welded joints are "a substantial improvement over the previous method of bolted joints." It notes that less maintenance is required on welded joints and argues that welded joints prolong the life of the rail and rolling stock. Though, as noted earlier, welded joints require little or no maintenance during early years of use, the problem of secondary batter will ultimately require maintenance of considerable cost. Thus, it cannot be said with any certainty on this record that over the long run, *i.e.*, the 40–50 year useful life of the rail, bolted joints will cost substantially less to maintain and repair than welded joints. As for prolonging the useful life of rail, the record does not show that rail with welded joints will last longer than rail with bolted joints if it be assumed that both types of joints are properly maintained. Useful life of rail is principally a function of the quality and extent of use of the rail itself upon which the type of rail joint, if properly maintained, would appear to have little effect. As for prolonging the life of rolling stock, the evidence is not sufficient to conclude that there has been any significant, or even measurable, reduction in rolling stock maintenance costs since the advent of welded rail, particularly in light of problems of secondary batter which has the same deleterious effects on rolling stock as worn bolted joints. Thus, while the record shows that welded joints result in some advantages over bolted joints, the advantages are not *so* substantial and track system *so* improved that welded joints should be considered a betterment over bolted joints for purposes of retirement-replacement-betterment accounting. Plaintiff may therefore charge to current expense the cost of replacing bolted joints with welded joints, in the same proportion as it charges to current expense the cost of replacing the rail itself.

Defendant points to another reason why plaintiff should capitalize the cost of replacing bolted joints with welded joints. In accounting for the replacements, plaintiff charged

to current expense not only the cost of the welded joints but also the book value of the replaced bolted joint materials (angle bars, bolts and washers). *I.e.*, plaintiff treated the accounting for the replaced joint as if it had been retired without replacement. Defendant says this is improper under replacement accounting as practiced by plaintiff because the asset account must reflect the fact that a joint was replaced, rather than simply retired. Plaintiff, on the other hand, says it is proper to charge to current expense both the welding cost and the book value of the retired bolted joint materials because the bolted joint was retired and the cost of the weld is part of the cost of rail. Clearly, defendant is correct. As held above, the cost of replacing a bolted joint with a welded joint should be accounted for as a replacement, *i.e.*, charged to current expense. Accordingly, such cost must be reduced by the salvage value of the retired bolted joint materials. Otherwise, plaintiff would be getting what is in effect a compounded deduction for a transaction which is in fact a replacement rather than simply a retirement without replacement.

In sum, the proper accounting treatment should be as follows: The cost of welded joints laid in replacement should be charged to current expense (in the proper proportion as above noted), and the charge should be diminished by the salvage value of the replaced bolted joint materials. Thus, the original book value of the joint materials remains in the account; and the accounting transaction is fully consistent with the method used by plaintiff for other replacements.

Rail salvage value issue

To understand this issue, a brief discussion of plaintiff's track renewal program will be helpful. Over the years and particularly with the advent of heavier rolling stock, plaintiff has sought to upgrade its track system by replacing lighter-weight rail with heavier-weight rail. Typically, the rail on main lines is replaced from time to time with heavier new rail; and the rail picked up off the main lines is used to replace lighter rail in secondary or branch lines. In turn, rail picked up from secondary or branch lines, if still in serviceable condition, is used to lay or replace industry, spur or yard

tracks. If not in serviceable condition, it is scrapped. Finally, industry, spur or yard rail is replaced when worn out and is sold as scrap. Ordinarily, a section of rail goes through all these steps during its 40–50 year useful life before disposal as scrap.

In accounting for track replacements under the Interstate Commerce Commission's Uniform System of Accounts for Railroad Companies, plaintiff assigns on its books a salvage value to rail picked up. This salvage value is important because, as earlier discussed, the charge to current expense taken under retirement-replacement-betterment accounting for the cost of rail laid in replacement and rail retired without replacement is reduced by the salvage value of the replaced rail in order to arrive at a figure representing allowance for depreciation for Federal income tax purposes for the asset account as a whole. The salvage value assigned by plaintiff to rail picked up depends on whether the rail is to be scrapped or is to be relaid as reusable rail. In 1955 and for many years previous thereto (since about 1919), plaintiff has assigned the values of $17.86 per net ton for rail to be sold as scrap and $22.32 per net ton for reusable rail. Plaintiff does not explain how it arrived at these figures. However, a fair inference from the record is that $17.86 per net ton was the approximate price of scrap in the 1920's; and $22.32 per net ton was a figure somewhere between the cost of new rail and scrap in the 1920's, and thus was deemed to be the reasonable value of reusable rail. In 1919, the price of new rail was $35.83 per net ton; during the 1920's, the price was about $38.

The issue here is the value to be assigned to reusable rail in 1955, to the extent that such rail was relaid as additions or betterments. Defendant says that $22.32 per net ton is unrealistically low because it represents a figure established many years ago when the cost of new rail and the price of scrap were but a fraction of their 1955 values. In 1955, new rail cost $93.70 per net ton and scrap sold for $43.75 per net ton. Accordingly, says defendant, reusable rail should be assigned a value somewhere between the price of new rail and the price of scrap, at a figure deemed to be the current fair market value of reusable rail. Defendant argues that such

value in 1955 should be $69.40 per net ton, midway between the price of new rail and the price of scrap. Defendant cites and relies on Rev. Rul. 67–145, 1967–1 Cum. Bull. 54, which holds that "railroads using the 'retirement method' of accounting for depreciation" must value reusable rail at "fair market values." Defendant also cites and relies on Rev. Proc. 68–46, 1968–2 Cum. Bull. 961, which holds that reusable rail laid in additions or betterments must be valued at a "fair market value somewhere between the new and scrap price for such rail," and such fair market value is determined "by averaging the new and scrap prices." Defendant says that it is reasonable to calculate fair market value in this way because (a) there is no established price for reusable rail in the marketplace since reusable rail is not sold by the railroads, due to a shortage of rail, and (b) reusable rail is worth less than new rail and more than scrap, and a value halfway between "has the merit of simplicity, reasonableness, and case of derivation." [11]

Plaintiff objects to defendant's approach to the valuation problem. While conceding that $22.32 per net ton is unrealistically low, plaintiff contends that the proper value should be the lower of cost or fair market value.[12] Plaintiff relies on a letter of technical advice, issued in 1964 by the National Office of the Internal Revenue Service relating to an audit of plaintiff's books for 1956–59, which holds that reusable rail should be valued at "the lower of actual costs or current fair market values." The letter of technical advice was later superseded by Rev. Rul. 67–145 and Rev. Proc. 68–46, *supra*. In 1955, the average investment cost of plaintiff's rail in place was $43 per net ton, and it is this value which plaintiff says should be assigned to reusable rail. Otherwise, says plaintiff,

---

[11] Plaintiff installs reusable rail for some of its industrial customers as side track; and in 1955, it charged such customers about 60 percent of the price of comparable new rail. While this tends to establish a fair market price on the traditional basis of a willing buyer and willing seller, it is not a truly reliable price since it includes installation cost and is subject to rebate depending on the later volume of use to which the track is subjected. Defendant, therefore, bases its fair market value of reusable rail on the formula, above noted, rather than the 60 percent figure.

[12] Plaintiff's reply brief says that "plaintiff recognizes that its previously assigned value of * * * [$22.32 per net ton] was arbitrary * * *" and that "plaintiff is willing to accept a value * * * of the lower of actual cost or fair market value * * *."

if fair market value is used under defendant's formula, the book value of reusable rail laid as additions or betterments is, in effect, written up above cost and results in the taxation of unrealized appreciation.

At this juncture, it should be pointed out that defendant does not challenge the value which plaintiff assigned to scrap in 1955 ($17.86 per net ton) even though the price of scrap in that year was $43.75 per net ton. The reason for this is that plaintiff reports as income the difference between the assigned scrap value and the proceeds of scrap sales so that, as a practical matter, it makes no difference what the assigned value is. Thus, the net effect is that the entire $43.75 per net ton current scrap value goes to reduce the charges to expense for replacements and retirements without replacement. By the same token, if plaintiff had assigned to scrap in 1955 a value higher than $43.75, say for example $50.75, the $7 difference, upon disposition of the scrap, would be charged to current expense, thus reflecting the fact that the decrease to current expense representing the assigned salvage value of scrap had been too high. Furthermore, defendant does not challenge the value plaintiff assigned in 1955 to reusable rail which was picked up and then relaid as replacements in kind. On reflection, it can be seen that the reason for this is that whatever value was assigned washed out of the accounting because the value assigned on pickup, which went to reduce current expense, was the same as the value charged to current expense upon relay, thus a wash. Therefore, defendant's only concern here, as noted earlier, is the value to be assigned to reusable rail laid as additions or betterments, for this value is capitalized on plaintiff's books and no corresponding charge to current expense is made until ultimate retirement.

After careful consideration of all the arguments in the parties' extensive briefs, I am constrained to conclude that defendant's position is the correct one. The evidence, including the testimony of expert accounting witnesses, persuades me that the approach set out in Rev. Rul. 67–145, *supra*, and Rev. Proc. 68–46, *supra*, is sound. The issue turns on the manner in which plaintiff employs retirement-replacement-betterment accounting. As discussed earlier, plaintiff charges to expense the current cost of making rail replacements. The

aggregate of such costs, reduced by the salvage value of replaced rail, thus represents the allowable depreciation deduction for such transactions for the account as a whole. After many years of an inflationary economy (particularly since World War II) and because rail has a long useful life (40–50 years), the current cost of making replacements (as opposed to retirements without replacement) bears no relationship to the historical cost of the rail in place. Thus, in 1955, plaintiff charged to current expense the $93.70 per net ton cost of laying new rail in replacement, even though the average cost of all rail in place was only $43 per net ton. The symmetry of replacement accounting demands that if the high costs of replacement are to be charged to current expense, then salvage value assigned to reusable rail for relay as additions or betterments must correspondingly be based on current values. Otherwise, the allowable deduction for depreciation for the account as a whole is distorted, will in effect tend to constitute accelerated depreciation, and thus will not reflect a reasonable allowance for "exhaustion, wear and tear (including a reasonable allowance for obsolescence)," as required by § 167 of the Internal Revenue Code (1954).

Plaintiff's argument that valuing reusable rail at current fair market value rather than historical cost results in taxation of unrealized appreciation is, at first blush, appealing but will not stand analysis for two reasons. First, under retirement-replacement-betterment accounting, as practiced by plaintiff, the value assigned to reusable rail is for the purpose of determining the extent to which the current charge to expense for replacements (and retirements without replacement) should be reduced, so to reflect a reasonable allowance for depreciation. Thus, although the net effect of valuing reusable rail at current fair market value rather than historical cost may result in less after-tax income to plaintiff, it does so not by taxing unrealized appreciation but simply by reducing a depreciation deduction to a reasonable level. Secondly, it makes no sense in the context of plaintiff's retirement-replacement-betterment accounting method to restrict the value assigned to reusable rail laid in additions or betterments to historical cost when the charges for replacements, which are immediately expensed, bear no relationship to

historical cost. Under plaintiff's theory, reusable rail would be valued in 1955 at $43 per net ton, which is less than the price of scrap ($43.75 per net ton) for that year. This is not reasonable and, as earlier discussed, violates the symmetry of retirement-replacement-betterment accounting.

Furthermore, the requirement of the Interstate Commerce Commission's Uniform System of Accounts for Railroad Companies for valuing reusable rail is fully consistent with defendant's proposition that reusable rail be assigned its current fair market value. Section 10.01–7(d) of the Uniform System of Accounts for Railroad Companies, in effect in 1955, defines "value of salvage," stating that "when such material [*e.g.*, rail] is retained and again used by the carrier [*e.g.*, reusable rail], the *value shall be determined* by deducting a fair allowance for depreciation from *current* prices of the material as *new*." The plain meaning of this is that reusable rail in 1955 should be valued at somewhere between $93.70, the current price of new rail, and $43.75, the current price of scrap, so that its value represents the price of the material "as new" less "a fair allowance for depreciation." Defendant's method of estimating this value, *i.e.*, halfway between the current prices of new rail and scrap, is reasonable and equitable since, on the average, reusable rail picked up by plaintiff from its lines has gone through about half its useful life. Plaintiff argues that new rail prices and scrap prices vary "due to wide fluctuations" and that it is not possible "on a current basis" to ascertain the average value. While the record shows that such prices do vary somewhat, the fluctuations in any given year are not so great as to make determination and use of a reasonable average an undue administrative burden. And, in any event, adjustments can be made at the end of any year to reflect the actual price experience for that year.

It is pertinent to note that in 1955, the Interstate Commerce Commission did not require plaintiff to value its reusable rail in accordance with the express dictates of § 10.01–7(d), *supra*. Rather, plaintiff was permitted to assign the value of $22.32 per net ton, a figure which no doubt was consistent with new rail prices and scrap prices many years ago but clearly is not a proper figure in a year when

new rail cost $93.70 per net ton and scrap sold for $43.75 per net ton.[13] Whatever may be the reason for the Commission's acquiescence in a value of $22.32 in 1955, the fact remains that § 10.01–7(d) of its Uniform System of Accounts for Railroad Companies expressly calls for determining salvage value in a manner wholly consistent with the theory and practice of retirement-replacement-betterment accounting here urged by defendant.[14]

Plaintiff contends that if it is required to assign to reusable rail laid as additions and betterments in 1955 such rail's fair market value, then it should be permitted to value scrap at the same figure. Thus, plaintiff argues, scrap should be valued at $69.40 per net ton so that upon disposition at $43.75 per net ton, it sustains a "loss," which "loss," says plaintiff, is "an offset against defendant's offset." This argument makes no sense within the context of retirement-replacement-betterment accounting as practiced by plaintiff. As earlier noted, the value plaintiff assigns to scrap at the time of pickup is, in reality, an interim figure which is adjusted depending upon the price for which scrap is actually sold. Thus, if scrap is valued on pickup at lower-than-prevailing scrap prices (as it was in 1955), the difference upon disposition is reported as income. If, on the other hand, scrap is valued on pickup at higher-than-prevailing scrap prices, the difference on disposisition should be charged to current expense. In either event, the final result must be that scrap is accorded its fair market value which goes to reduce current charges for replacements and retirements without replacement. This is fully consistent

---

[13] The railroads were not uniform in the values they assigned to reusable rail in 1955. The record shows that values ranged from $68.34 per net ton down to values lower than $22.32 per net ton. (Finding 27.)

[14] At trial, a former chief of the section of accounting of the Interstate Commerce Commission testified that the interpretation and application of § 10.01–7(d) is governed by the "major principle" that in no case shall "salvage value exceed the original cost." Despite the testimony, nowhere in the Commission's Uniform System of Accounts for Railroad Companies does there purport to be a rule stating such "major principle" and the witness could point to none. No doubt, such "major principle" has to do with the fact that the Interstate Commerce Commission, a rate-making regulatory agency, is obliged to see that the railroads do not overstate the book value of their assets as a whole. Otherwise, unjustified rate increases might be urged. Nevertheless, § 10.01–7(d) is clear on its face, its meaning is plain and unambiguous, and it remains a rule currently in force (¶ 18 under "Regulations Prescribed" in the 1968 edition of the Uniform System of Accounts for Railroad Companies).

with the theory and practice of retirement-replacement-betterment accounting as used by plaintiff and as earlier discussed.

Finally, plaintiff contends that Rev. Rul. 67–145, *supra*, upon which defendant relies, is not applicable in this case because it was issued in 1967, well after the tax year in suit, and cannot be given retroactive effect. Rather, plaintiff says defendant should be bound by the letter of technical advice issued in 1964 which respect to the audit of plaintiff's books for 1956–59. There is no merit to this argument. The Commissioner of Internal Revenue is empowered retroactively to correct mistakes of law in the application of the tax laws to particular taxpayers. *Dixon* v. *United States*, 381 U.S. 68 (1965). Rev. Rul. 67–145, *supra*, supersedes and correctly overrules the letter of technical advice, and there was no abuse of discretion in applying it here in support of the Government's setoff defense. Furthermore, plaintiff has shown no detrimental change of position in reliance on the letter of technical advice from which it can argue that retroactive application of the Revenue Ruling is inequitable.

To sum up: Plaintiff, in accounting for reusable rail picked up in 1955, must assign to such rail, to the extent it was laid as additions and betterments, its current fair market value in 1955, which equitably and for ease of calculation and administration is halfway between the cost of new rail and the price for scrap in 1955.

Protective Work Issue

In 1955, plaintiff carried out 28 construction projects (total cost: $121,026.70) directed to protecting and maintaining its rail embankments near waterways. The work was generally of five types: (a) channel diversion, (b) construction of dikes, dams and jetties, (c) bridge grade raising, (d) riprap construction, and (e) bridge and culvert extensions or modifications. The project relating to channel diversion entailed dredging a creek bed to straighten it and divert the flow of water away from plaintiff's track embankment which was being eroded away. The creek had changed course and was threatening the integrity of the embankment. Six projects related to construction of dikes, dams and jetties. Five of

them involved building rock-filled timber cribs, steel jetties and, in one instance, a retaining wall, in streams or rivers to deflect waterflow away from plaintiff's track embankments. The sixth project involved placing an earth blanket over seepage points in a levee to protect the levee and a railroad bridge during high water of a river. The project relating to grade raising involved raising the end of a railroad bridge to allow passage thereunder of drift material which endangered the bridge during heavy rains. The river which the bridge spanned had silted up, due to upstream construction of a dam, thus raising the river level at times of high water. Two projects related to riprap construction. In both projects, riprap was placed along the banks of a river or creek to slow down and divert waterflow and prevent further erosion which was endangering plaintiff's rail embankments. Eighteen of of the projects related to bridge and culvert extensions. In general, the projects involved modification of existing culverts, trestles, walls, and pipes to alter or divert waterflow which was eroding rail embankments. In some instances, new culverts, trestles, walls, or pipes were installed near existing facilities of a like nature, the purpose of which was to arrest erosion of the embankment areas due to changed waterflow patterns.

Railroad embankments have an indefinite service life. Unless attacked by outside forces, they remain in serviceable condition so long as the railroad operates trains over its rail lines. Embankments near waterways are built originally by plaintiff using good engineering practices to provide permanent protection against water erosion. However, unforeseen and unforeseeable changes in waterflow patterns near the embankments sometimes require remedial steps to arrest erosion. It is not possible to predict when remedial steps will be necessary. Plaintiff is engaged in a continuous program of inspection and evaluation of damage to its embankments. When necessary to correct deterioration, the steps taken are intended to arrest the problem and prevent a premature end to the service life of the embankment. The nature of the corrective work done depends upon the severity of damage and the possibility of continued damage. The work is done in the simplest and cheapest manner under the circumstances to

insure an end to the particular erosion problem and to keep the rail line in safe operating condition.

Plaintiff contends that the costs of the projects here in issue are deductible as "ordinary and necessary" business expenses pursuant to § 162 of the 1954 Internal Revenue Code. Plaintiff says "the work done was in the nature of repairs and maintenance" in order to "maintain the * * * property [*i.e.*, the rail lines and embankments] in an ordinary efficient operating condition or to prevent the useful life from being shortened due to unusual circumstances." Plaintiff points to Treas. Reg. § 1.162–4 which says in pertinent part that the cost of repairs "which neither materially add to the value of the property nor appreciably prolong its life but keep it in an ordinary efficient operating condition, may be deducted as an expense * * *."

Defendant, on the other hand, says that the costs in issue must be capitalized pursuant to § 263 of the 1954 Code which provides in part that no deductions shall be allowed for "* * * any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." Defendant also relies on Treas. Reg. § 1.263(a)–1 which provides in part that no deduction shall be allowed for "* * * amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer such as plant or equipment, or (2) to adapt property to a new or different use." Defendant says that each project here in issue consists of "a new facility or addition of a permanent nature," and points particularly to the retaining walls and culverts as examples of a "capital asset or improvement, representing new and permanent construction with a useful life extending beyond the year in which the expenditure was incurred."

Whether expenditures are currently deductible or must be capitalized depends on the purpose for which the expenditures are made. As stated in *Griffin & Co.* v. *United States*, 182 Ct. Cl. 436, 456, 389 F. 2d 802, 814 (1968):

> * * * If their purpose was merely to repair property and thus keep it in good condition during its probable useful life, the expenditures were deductible as business expenses. *Illinois Merchants Trust Co.*, 4 B.T.A. 103, 106 (1926). On the other hand, if the purpose of the expendi-

tures in question was to improve property and thus increase its value, the expenditures were capital in nature and were not deductible as business expenses. *Duffy* v. *Central R.R.*, 268 U.S. 55, 62–63 (1925). The question of purpose is, of course, a factual issue. *Russell Box Co.* v. *Commissioner*, 208 F. 2d 452, 454 (1st Cir. 1953).

The record here supports plaintiff. The construction work, though differing in detail from project to project, all was undertaken as remedial steps to correct problems of water erosion which threatened to render unserviceable already existing railroad embankments, some of which had been in place for as long as 60 years. The value and original service life of the embankments were not increased by the corrective work done; nor were the embankments adapted to any new or different use. *Plainfield-Union Water Co.* v. *Commissioner*, 39 T.C. 333 (1962). Rather, the work simply arrested and corrected a condition of deterioration which threatened a premature end to the otherwise indefinite service life of the embankments. *American Bemberg Corp.* v. *Commissioner*, 10 T.C. 361 (1948), *aff'd*, 177 F. 2d 200 (6th Cir. 1949); *Midland Empire Packing Co.* v. *Commissioner*, 14 T.C. 635 (1950). The fact that some of the construction work may have been relatively permanent and had a useful life of more than one year is not controlling. *Connecticut Light & Power Co.* v. *United States*, 156 Ct. Cl. 304, 299 F. 2d 259 (1962). Nor is it controlling that the work restored the embankments to their pre-erosion condition and added value as compared with the situation immediately prior to the work. The proper test, as stated in *Oberman Mfg. Co.* v. *Commissioner*, 47 T.C. 471 (1967), is "whether the expenditure materially enhances the value, use, life expectancy, strength or capacity as compared with the status of the asset prior to the condition necessitating the expenditure."

This court's decision in *Kansas City Southern R.R.* v. *United States*, 125 Ct. Cl. 287, 112 F. Supp. 164 (1953), is fully in point.[15] There, the integrity of railroad track beds was threatened by water pockets which developed in the subsurface beneath the beds. The problem was corrected by driving into the ground at the end of each railroad tie wooden

---

[15] The *Kansas City Southern* case is followed in Rev. Rul. 54–356, 1954–2 Cum. Bull. 82, and Rev. Rul. 58–278, 1958–1 Cum. Bull. 92.

poles six inches in diameter, at a cost of $116,548.77. This court held that such cost was deductible as a current expense because the problems created by water pockets "appear casually, and, as they appear, they present a problem of maintaining an existing completed track in a safe and economical operating condition." The court further pointed out that the fact that the poles themselves had an anticipated useful life of many years was not significant because the "railroad track, and the parts of it where the poles were driven were no more useful than the other parts which had not needed this work." The rationale of the *Kansas City* case is applicable here. The record shows that the erosion which threatened the integrity of plaintiff's embankments "appears casually" at times and places which plaintiff cannot predict and was due to changed waterflow conditions. The erosion problems were thus corrected as they appeared, to protect and maintain the embankments in a safe operating condition. This is not a case where, at the time of original construction of the embankments, it was possible to foresee and make permanent preparation for all contingencies of erosion damage. In fact, plaintiff's embankments were constructed originally under sound engineering practices to protect against waterflow as it then existed; and the construction was done with the expectation that the embankments would last indefinitely. Were it otherwise, the costs here in issue might properly be considered as capital expenditures.

At the oral argument in this case, defendant argued that the instant situation is distinguishable from *Kansas City Southern R.R.* v. *United States*, *supra*, because plaintiff set up on its books separate accounts for the cost of the protective work here at issue in such a manner as to indicate that those costs were treated as capital improvements, and therefore as depreciable assets rather than as repairs or maintenance expenses.

Plaintiff acknowledges that the cost for the protective work at issue was placed in Interstate Commerce Commission accounts 3 and 6 which are capital accounts. However, it is by now well-settled that bookkeeping entries, while in some circumstances of evidential value, are not determinative for Federal tax purposes. That decision must rest upon

the actual facts. *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179, 187 (1918); *Helvering* v. *Midland Mut. Life Ins. Co.*, 300 U.S. 216, 223 (1937); *A. Kreamer, Inc.* v. *United States*, 66 Ct. Cl. 308, 316 (1928); *Allen* v. *Commissioner*, 117 F. 2d 364, 368 (1st Cir. 1941); *Commissioner* v. *North Jersey Title Ins. Co.*, 79 F. 2d 492, 493 (3d Cir. 1935); *Sitterding* v. *Commissioner*, 80 F. 2d 939, 941 (4th Cir. 1936); *Commissioner* v. *Landers. Corp.*, 210 F. 2d 188, 192 (6th Cir. 1954): *Northwestern States Portland Cement Co.* v. *Huston*, 126 F. 2d 196, 199 (8th Cir. 1942); *Terminal Investment Co.*, 2 T.C. 1004, 1013 (1943). Any doubt that the rule is otherwise in the instant situation because these accounts were established by the Interstate Commerce Commission was early dispelled in *Old Colony R.R.* v. *Commissioner*, 284 U.S. 552 (1932), where the Supreme Court stated:

> * * * Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner, nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the revenue acts. * * * [*Id.* at 562.]

Accord, *Connecticut Light & Power Co.* v. *United States*, 156 Ct. Cl. 304, 310, 299 F. 2d 259, 263 (1962); *New York Central R.R.* v. *Commissioner*, 79 F. 2d 247, 252 (2d Cir. 1935), *cert. denied*, 296 U.S. 653; *Mine Hill & Schuylkill Haven R.R.* v. *Smith*, 184 F. 2d 422, 426 (3d Cir. 1950), *cert. denied*, 340 U.S. 932 (1951); *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, 579 (8th Cir. 1943), *cert. denied*, 319 U.S. 752.

Defendant also argues that Mimeo 58, the lists of depreciable property submitted by plaintiff, the terms letter, plaintiff's acceptance thereof, and the later revised schedules demonstrate that the I.C.C. accounts were expressly established for tax purposes. The above discussion with respect to the donated property issue is equally applicable to this argument by defendant. The purpose of the schedules of depreciable property, Mimeo 58, and the terms letter was to provide that the basis for depreciation of the road property was to be determined in accordance with the Internal Revenue Code. Even assuming that the statement "Donated prop-

erty or contributions or grants in aid of construction from any source must be excluded" was a condition independent of the just-stated purpose, plaintiff's acceptance thereof was conditional and plaintiff is entitled to the benefits of the changes in the law by the Supreme Court's decision in *Brown Shoe Co.* v. *Commissioner*, *supra*, as discussed above.

This rationale also disposes of the first and third grounds put forth by defendant for distinguishing the instant case from *Kansas City Southern R.R.* v. *United States*, *supra*. That is to say that (1) the item of protective work involved in *Kansas City Southern R.R.* v. *United States*, *supra*, was not included in the itemized list of depreciable properties so that it retained its character as an expense; and (3) plaintiff agreed that the I.C.C. accounts would be binding for Federal tax purposes.

Defendant also says that the *Kansas City Southern R.R.* case does not apply because when it was decided, the I.C.C. regulations no longer required the capitalization of the items that were in issue there, but permitted them to be expenses. As already indicated, however, the accounting procedure established by a regulatory agency is not determinative of Federal tax liability. Each case must rest upon the actual facts. This was the court's approach in the *Kansas City Southern R.R.* case, as shown by the following discussion:

> Our problem is to determine whether the pole-driving work was maintenance work or capital improvement work. If, at the time of the original construction of the railroad, it had been possible to foresee where the water pockets would appear, and the poles had then been driven, their cost would, of course, have been a capital cost. But the water pockets develop and appear casually, and, as they appear, they present a problem of maintaining an existing completed track in a safe and economical operating condition. If in particular locations it should be found that ordinary railroad ties were subject to extraordinary deterioration because of soil conditions or insects, and the ties were replaced with others of a type which would withstand these attacks better and longer, that replacement would, we think, be maintenance. The fact that the replacements, once made, would be good for many years, would not seem to be significant. When a building or a machine is repaired, it is not unusual that the repaired portion is better than and will outlast the

> parts that have not yet needed repairs. In the instant case the railroad track, after the poles were driven, was still just a railroad track, and the parts of it where the poles were driven were no more useful than the other parts which had not needed this work. [125 Ct. Cl. at 289, 112 F. Supp. at 165–66.]

Although the court noted the I.C.C. accounting procedure, it did so only as *support* for the determination it had made on the facts and *not as authority* therefor. Defendant has failed to distinguish the instant case from *Kansas City Southern R.R.*, *supra*, which, as found by the trial commissioner, is fully in point.

In sum, the construction projects were in the nature of repairs and maintenance, rather than capital improvements, and their cost is currently deductible.

Vacation Pay Accrual Issue

In 1955, plaintiff accrued and took as a deduction on its Federal income tax return an amount estimated to be its liability for vested vacation pay earned by its employees in 1955 and payable in 1956. Because plaintiff did not know how much it would in fact pay out in 1956 for vacation pay liability accrued in 1955, it had to estimate its liability on the basis of past experience.

Prior to 1955, plaintiff used the following method to estimate its vacation pay liability accrued during a given year: Taking the year 1952 as an example, plaintiff first determined the actual payments made to its employees in 1952 (for vacation pay liability accrued in 1951). The amount of actual payments made in 1952 was then adjusted for prospective salary changes, changes in employees' vacation brackets, or prospective changes in employment status; and the adjusted figure became the estimated liability for 1952 (to be paid out in 1953) and formed the basis of the deduction taken on plaintiff's 1952 tax return (filed in 1953).

Starting in 1955, plaintiff changed its method of estimating accrued vacation pay liability. Although plaintiff maintained its books of account on the basis of the calendar year, it closed its books for vacation pay liability purposes (for some unexplained reason) at the end of the first 10 months of

1955. Thus, when estimating its accrued liability for 1955, plaintiff did not use as a basis the actual payments made in 1955 but rather used the actual payments made during the first 10 months of 1955, plus an estimate of the payments made during the last 2 months of 1955. The estimate for the last 2 months of 1955 was based on payment experience in 1954, for which plaintiff determined that about 20 percent of the vacation payments were made during the last 2 months of that year. Plaintiff assumed that the same percentage would apply in 1955. In fact, the actual payments made in 1955 were $4,926,897, whereas plaintiff based its deduction on a figure of $5,233,624.70, a difference and overstatement of $306,727.70. Plaintiff arrived at the $5,233,624.70 figure by summing up $4,372.649.93, the actual payments made for the first 10 months of 1955, and $860,974.77, the amount estimated to be the payments for the last 2 months of 1955, based on 1954 experience.

Defendant says that the method used by plaintiff in 1955 was improper and that plaintiff should have used the method it had consistently employed prior to 1955. Had plaintiff done so, its deduction for 1955 would have been $306,727.70 less than the deduction actually taken. Plaintiff concedes that in 1955 it changed its method of estimating accrued liability but argues that the deduction taken was nonetheless "reasonable" because "the accrual deduction claimed for 1955 exceeded by 4% the amount actually paid in 1956 for vacation pay earned and vested in 1955." Plaintiff points to a rule-of-thumb used by the Internal Revenue Service which permits a tolerance of 4 percent between accrual estimates and actual payments.

At the outset, it is noted that plaintiff is wrong in stating that "the accrual deduction claimed for 1955 exceeded by 4% the amount actually paid in 1956." In fact, the difference was about 5.3 percent (finding 36). In any event, plaintiff cannot prevail for more fundamental reasons, discussed below.

Section 461 of the 1954 Internal Revenue Code and Treas. Reg. § 1.461-1(a)(2) set out rules for determining the proper year and amount in which deductions may be taken. The Regulations state that taxpayers on the accrual method of accounting must deduct expenses in "the taxable year in

which all the events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy." Furthermore, the Regulations state:

> Where a deduction is properly accrued on the basis of a computation *made with reasonable accuracy* and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made. (Emphasis added)

The requirement that estimates be "made with reasonable accuracy" means that estimates must be based on the best available information. The best available information for estimating accrued vacation pay liability in any given year is the actual payments made during that year for vacations which accrued the year before; and prior to 1955, it was on such basis that plaintiff estimated its accrued liability. Plaintiff has made no persuasive showing why it changed from this method for the year 1955. A letter of explanation to the Internal Revenue Service dated June 8, 1962, simply stated that accruals for vacation pay liability beginning "in 1954" were made "on the books of account, making it necessary to base the accrual on information available at the time the books are closed." There was no explanation why the books were closed for vacation pay liability purposes at the end of 10 months when for all other purposes, plaintiff's books are maintained on the basis of the calendar year. The only reasonable inference is that at the time plaintiff's tax return for 1955 was prepared (in early 1956), the actual payment figures for the last 2 months of 1955 had not been summed up or simply were ignored, though they obviously were available and clearly should have been used as plaintiff had done in earlier years.

The 4-percent tolerance rule used by the Internal Revenue Service has no application here, even if plaintiff came within it. As correctly stated by defendant, that rule "does not justify a deduction that is four percent more than the proper amount merely because the taxpayer, for reasons not explained in the record, wishes to change its method of estimating accruals, and thereby achieve an increased deduction on the accrual basis." In no event can the 4-percent rule be

used to justify estimated accruals based on information other than the best available.

Accordingly, the deduction taken by plaintiff for accrued vacation pay liability for 1955 was overstated by $306,727.70, and defendant is entitled to the appropriate offset against any recovery by plaintiff.

Mexican Tax Credit Issue

The issue is whether plaintiff can take a tax credit against Federal income taxes for taxes paid to Mexico in 1955. Plaintiff says it is entitled to a credit of $74,767.97 pursuant to §§ 901–904 of the 1954 Internal Revenue Code. Defendant challenges plaintiff's right to the tax credit. The Internal Revenue Service held that plaintiff was entitled to a deduction from gross income for such tax but not a tax credit. The factual underpinning of this issue is in all material respects identical to *Missouri-Illinois R.R.* v. *United States*, 180 Ct. Cl. 1179, 381 F. 2d 1001 (1967), and *Missouri Pacific R.R.* v. *United States*, 301 F. Supp. 839 (E.D. Mo. 1967) *aff'd in part, rev'd in part and remanded*, 411 F. 2d 327 (8th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970). In both cases, it was held that the taxpayer was entitled to the claimed tax credit. Nevertheless, defendant again seeks to litigate the issue.

The defendant contends that no tax "was imposed on plaintiff by the Government of Mexico." This argument is not persuasive. The facts show that on January 1, 1954, a new Mexican federal income tax law became effective. This statute was entitled "Ley del Impuesto Sobre la Renta," which translated into English means "Income Tax Law on Rents." Schedule VI of this statute imposed a tax on income derived from:

> XIV.—Rentals, prizes, royalties and retributions of all kinds which are received as owners or holders of personal property or of rolling stock from the persons to whom they grant the use or exploitation of the same without transferring the ownership thereof.

Under Article 129th, the lessor of rolling stock is entitled to certain deductions. However, paragraph XIV provides that those taxpayers to which paragraph III of Article 6th refers,

who receive income for any of the reasons set forth in paragraph XIV, shall pay the tax in Schedule I. The plaintiff is a taxpayer within paragraph III of Article 6th. Schedule I provides in Article 26th that the basis of the tax in said schedule shall be the taxable profit which is the difference between the income received by the taxpayer during a period and the deductions authorized by the law.

This law clearly imposed a tax on income received by plaintiff as per diem charges paid by Mexican railroads to the plaintiff for use of plaintiff's railroad cars on Mexican railroad lines in Mexico in 1955 (the taxable year involved in this case).

The defendant argues further that "no tax was paid by the plaintiff to the Government of Mexico". It is concluded that this argument is without merit.

Article 28th of Schedule I of the above statute provides that when because of the nature and characteristics of the operations carried out by the taxpayer it is not possible, by ordinary procedures, to determine with exactness the taxable income, the department of the treasury may enter into agreements for the determination of the tax base. The Mexican treasury department considered that it was difficult to determine the taxable income of the foreign companies leasing rolling stock into Mexico and to check and verify the expenses and taxable income of these companies. Therefore, the Mexican Government decided to enter into agreements, under Article 28 of the income tax law, for the payment of the tax.

On December 31, 1954, an agreement was executed by representatives of United States and Canadian railroads, of the Government of Mexico and of the Government-owned railways of Mexico, with respect to the payment of the tax on the income received by the United States and Canadian railroads from Mexican railroads. This agreement recited that certain United States and Canadian railroads (including the plaintiff herein) received income from sources located in the Republic of Mexico from the rental of rolling stock to the National Railways of Mexico and the Mexican Railway, *which income was held to be subject to the Mexican income tax law.* The agreement thereafter provided that the income received from the rental of rolling stock while in the Republic

of Mexico, by the United States and Canadian railroads which do not operate in Mexico through agencies or branches, was subject to payment of Mexican income tax under Schedule VI of the income tax law; that *the Mexican railways were authorized and obligated to retain the tax for which the United States and Canadian railroads were liable, and to pay to the Mexican treasury the amount so retained;* that the amounts retained shall be equal to the tax due; that the payment of the amounts so retained, to the Mexican Government, would be in full satisfaction of the obligations of the United States and Canadian railroads for Mexican income taxes on the rolling stock rentals; that each United States and Canadian railroad was obligated to file an income tax return setting forth all income from the Mexican railroads for the rental of rolling stock and the total Mexican income tax due thereon, and that the department of the treasury and public credit of the Republic of Mexico agreed that the retention of the difference between the basic per diem rate and the Mexican per diem rate would fully satisfy the obligations of each of the United States and Canadian railroads for Mexican income taxes on rolling stock rentals. The agreement was executed by representatives of United States and Canadian railroads, the Government of Mexico and the National Railways of Mexico and Mexican Railway, relating to the manner of payment of the income tax obligations of the United States and Canadian railroads (including the plaintiff). A similar agreement was executed July 18, 1955, covering rentals received from some of the privately owned railroads in Mexico. These privately owned lines constitute a very small part of the railroads in Mexico, with the main railroads being agencies of the Mexican Government. All of the agreements were retroactive to January 1954.

Pertinent clauses of the agreement between the American railroads (including plaintiff), Canadian railroads and the Minister of Finance and Public Credit (on behalf of the Government of Mexico) and the General Manager of the Government-owned Mexican railroads are as follows:

CLAUSES:

1. The revenue received by American and Canadian Railroads not operating in Mexico through agencies or

branches derived from rental of rolling stock while in the Republic of Mexico, is subject to the payment of income tax, as per Item VI.

2. The National Railways of Mexico and Mexican Railway, with authority provided for in Article 201 of the Income Tax Law, are—compelled to withhold the tax accrued by the American and Canadian-Railroads on payments derived from rental of rolling stock while in the Republic of Mexico. The withholding is to be made on the total of the tax accrued and, therefore, the American and Canadian Railroads are exempt from the obligation decreed in Article 169 of—Rulings of the Income Tax Law, which in essence is the payment of the tax through the cancellation of stamps on receipts issued to—the National Railways of Mexico and Mexican Railway for taxes derived from the rental of rolling stock while in the Republic of Mexico.

3. The National Railways of Mexico and Mexican Railway agree to pay without discounts to each of the American and Canadian Railroads listed on enclosure "A" signed by each party and included in this—Agreement, the basic Per-Diem rate in effect at the time it is due, to retain the difference between the basic Per-Diem rate and the Mexican Per-Diem rate, and to pay the amounts withheld to the Mexican Government as the total obligations of the American and Canadian Railroads, in accordance with the Income Tax Law of Mexico regarding the rental of rolling stock.

4. The American and Canadian Railroads are to file with the Ministry of Finance and Public Credit during the month of January of each year a declaration of Income Tax earned the previous year, wherein all of the revenues received by the Mexican Railroads through the rental of rolling stock are to be mentioned and the total of the tax due on same.

5. It is agreed that the declarations of Income Tax filed individually by the American and Canadian Railroads listed on enclosure "A", will include a statement of the total of the taxes mentioned as earned and withheld by the National Railways of Mexico and Mexican Railway, in accordance with Articles 201 and 28 of the Income Tax Law of Mexico. It is also agreed that the revenue for the rental of rolling stock mentioned in said declarations will be computed at the basis of the Mexican Per-Diem rate.

6. The Ministry of Finance and Public Credit of the Republic of Mexico agrees that the withholding of the difference between the Basic Per-Diem rate and the

Mexican Per-Diem rate mentioned in—Clause 3, will cover completely all obligations of each of the American and Canadian Railroads listed on enclosure "A" of the Income Tax Law of Mexico on rental of rolling stock. The Ministry agrees, in addition, to furnish to each of the American and Canadian Railroads through a receipt or other form, a statement certifying said obligations.

7. The Ministry of Finance and Public credit will grant the National Railways of Mexico and the Mexican Railway for as long as—this obligation of payment of tax on rental of rolling stock exists, a subsidy equal to the amount of taxes withheld.

The tax withheld by the Mexican railroads which were parties to the tax agreements was computed, in accordance with such agreements, as the difference between the basic per diem rate and the Mexican per diem rate. In the case of railroads not parties to the agreements, the tax was 10 percent of the gross rental.

In the absence of any tax agreements, specific provisions of the Mexican income tax statute provided for the withholding of 10 percent of the gross rentals. In such instances, while the rental income would also be taxed under Schedule I of the Mexican income tax law, deductions would be permitted (such as salaries, overhead, depreciation, and professional services).

The Mexican railroads which were not parties to the tax agreements were obligated to pay the amount of the tax withheld from the gross rentals earned, directly to the Mexican treasury department.

The Mexican income tax law does not provide for a subsidy to the Mexican railroads, but this law does hold those obligated to withhold amounts as tax, liable at all times jointly with the taxpayer for payment of the tax.

The Association of American Railroads (AAR) sets per diem rental rates for freight cars which are operated off the line owning the car and on other railroad lines. The freight car per diem rate for 1955 was $2.40, which was the amount that one United States or Canadian railroad paid another United States or Canadian railroad for each calendar day a freight car owned by the second railroad remained on the first railroad's lines. The per diem rate paid by the Mexican railroads in 1955 for use of American freight cars was $3.40,

of which $1.00 was withheld by the Mexican railroads as payment for tax due the Mexican Government and $2.40 was paid to the American railroad whose cars were used. For 1955, plaintiff claims payment of taxes to Mexico of $85,-656.87, for which it claims a tax credit of $74,767.97 under §§ 901–904 of the Internal Revenue Code for 1954.

It is concluded that the tax of $85,656.87 imposed by the Mexican income tax law upon the freight rentals earned by the plaintiff while its railroad cars were in Mexico in 1955, and which tax was withheld by the Mexican railroads for the Mexican treasury, was a payment by the plaintiff of such taxes to the Mexican Government. Furthermore, it was a foreign income tax within the meaning of the Internal Revenue Code of the United States. The fact that the payment was made through a system of withholding and debits and credits in accordance with the accounting and fiscal policies and procedures of the Government of Mexico does not detract from its status as a payment of the taxes due by the plaintiff. The system is much like that used in the United States where our government withholds income tax from the salaries of its employees. Such amounts are later credited to the income tax due by the taxpayer through a debit and credit system between the Internal Revenue Service and the Treasury. The taxpayer never sees the withheld funds, never has them in his possession and never personally pays the actual dollars to anyone. Yet, he is considered as having paid the tax to the extent of the withheld funds. This is simply the modern and logical way of handling such payments that has been in vogue in this country for many years. Under these circumstances, it is surprising that the Internal Revenue Service has questioned the withholding procedure by which the plaintiff paid its income taxes to the Mexican Government in 1955. The procedure established by the Mexican statute and the above agreement made unnecessary the conversion of Mexican pesos into dollars and the payment of same to plaintiff as rent on the cars and the subsequent conversion of the dollars to pesos and their payment by plaintiff to the Mexican treasury. Even if such payments had been made entirely in pesos in Mexico, such a procedure would have been more complicated than that which was used. In

any event, the Government of Mexico could adopt any procedure it desired, and it did so. We have no right to complain.

The fact that the Mexican Government later granted subsidies to the Mexican railroads equal to the plaintiff's tax payments does not change the fact that the plaintiff made the payments. This is wholly an internal Mexican affair that is of no concern to us. As a matter of fact, most of the railroads were owned and operated by the Mexican Government. Under these circumstances, the subsidies were no doubt accomplished by debits and credits within the government. But here again, we are not concerned with what Mexico did in this regard.

The plaintiff is entitled to the tax credit of $74,767.97 on the $85,656.87 foreign income tax it paid to Mexico in 1955.[16] *See Missouri Pacific R.R.* v. *United States*, 183 Ct. Cl. 168, 392 F. 2d 592 (1968).

Davis, *Judge*, dissenting in part:

I join the court's opinion except for the "Donated Property Depreciation Issue" and the "Protective Work Issue", on both of which I would hold for the Government.

Donated Property Depreciation: The decisive question, slighted in the court's opinion, is the purpose of the "donors" with respect to the particular properties. *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943), went the way it did because the Court thought that "the farmers and other customers who furnished these funds" could not have intended to confer a gratuitous benefit on the utility through contributing to its capital; to those "donors" the payments were simply part of the price of the service. 319 U.S. at 102–03. *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583 (1950), was decided the other way because "the contributions to petitioner [the shoe company] were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large." 339 U.S. at 591. In other words, those "community groups" desired to, and did,

---

[16] The defendant has conceded that, if the tax was imposed and paid, the plaintiff is entitled to such credit under Sections 901–904 of the Internal Revenue Code of 1954.

grant gratuitous benefits to that taxpayer in the form of contributions to its capital. The properties in both decisions were exhaustible assets used in the taxpayer's business as part of its capital, giving some economic benefit to the company, and were of the type normally subject to depreciation; in both cases, too, assets were given, not money which could have been used for non-capital ends. These common factors did not differentiate the cases. What made the difference were the quite distinct purposes and attitudes of the two sets of "donors". Plaintiff insists that *Brown Shoe* limited the *Detroit Edison* rule to contributions made directly to obtain goods, services, or privileges, but, as I see it, the later opinion did not give *carte blanche* to other properties given without donative intent; the emphasis was, rather, on whether the giver had "a definite purpose to enlarge the working capital of the company." 339 U.S. at 591.

In this instance, it is evident to me that Congress, which funded all or the lion's share of the "donations" as part of the federal highway program, did not have in mind awarding any substantial gratuities to the railroads or increasing their capital. The intended beneficiaries of the program, ultimate and immediate, were the people at large, the auto-travelling segment of the public, and the trucking industry. See the extensive discussion of Mr. Justice Brandeis in *Nashville, Chattanooga & St. Louis Ry.* v. *Walters*, 294 U.S. 405, 416 ff. (1935). The benefits to the railroads were small, indirect, and merely incidental—not, as in *Brown Shoe*, large, direct, intended, and immediate. The highway program was certainly not undertaken in order to give free aid to the railroads. What they may have gained was no more than a minor by-product of the overriding aim of Congress (and the states) to reach very different goals. The physical assets left with the railroads were not central to their business, as in *Brown Shoe* and *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, 643 (C.A. 3, 1949), but were peripheral and tangential. That the railroads were to receive these items was not the prime and significant purpose of the Federal Government or the states, but a casual consequence, as it were, of the highway program which had other ends.

The lack of any desire to give free capital to the railroads is spelled out, almost in terms, in the Federal-Aid Highway

Act of 1944, 58 Stat. 838, 841, § 5(b),[1] which made participating railways "liable to the United States for a sum bearing the same ratio to the net benefit received by such railway from such project that the Federal funds expended on such project bear to the total cost of said project," and provided a mechanism for determining and collecting such liability. "In no case", moreover, were the total net benefits to the railroad to be more than 10% of the cost of the project. Neither in this legislation nor in any other facet of the program do I find any significant purpose to make a free contribution to the railroads' capital.[2]

The court leans heavily on an assumed obligation on plaintiff's part to replace the facilities at its own expense. The defendant points out that only 42 of the 173 agreements embody such an obligation expressly; the rest are silent on the point and it may well be that there is no such responsibility. Even

---

[1] "Any railway involved in any project for the elimination of hazards of railway-highway crossings paid for in whole or in part from funds made available under this Act, shall be liable to the United States for a sum bearing the same ratio to the net benefit received by such railway from such project that the Federal funds expended on such project bear to the total cost of such project. For the purposes of this subsection, the net benefit received by a railway from any such project shall be deemed to be the amount by which the reasonable value of the total benefits received by it from such project exceeds the amount paid by it (including the reasonable value of any property rights contributed by it) toward the cost of such project; and in no case shall the total benefits to any railway or railways be deemed to have a reasonable value in excess of 10 per centum of the cost of any such project. The liability of any railway to the United States with respect to any such project may be discharged by paying to the United States, within six months after the completion of such project, such amount as the Commissioner of Public Roads determines to be the amount of such liability. Any such determination of the Commissioner shall be made on the basis of recommendations made to him by the State highway department and on the basis of such other information and investigation, if any, as the Commissioner deems necessary or proper. If any such railway has failed so to discharge its liability to the United States with respect to any project within six months after the completion thereof, the Commissioner of Public Roads shall request the Attorney General to institute proceedings against such railroad for the recovery of the amount for which it is liable under this subsection. The Attorney General is authorized to bring such proceedings on behalf of the United States in the appropriate district court of the United States, and the United States shall be entitled in such proceedings to recover such sums as it is considered and adjudged by the court that such railway is liable for in the premises. Any amounts paid to or recovered by the United States under this subsection shall be covered into the Treasury as miscellaneous receipts."

[2] The agreement for construction of new highway underpasses gave the governmental bodies the right to construct without paying to plaintiff any other compensation for an easement. Such underpasses account for almost three-quarters of the amount involved in this case with respect to the "donated property" issue.

on the court's assumption, there are two comments to be made. Depreciation reflects the cost of an existing capital asset, not the cost of a potential replacement. *Weiss* v. *Wiener*, 279 U.S. 333 (1929); *Helvering* v. *Lazarus & Co.*, 308 U.S. 252, 254 (1939). And even if plaintiff did have the replacement obligation the court finds, that would not outbalance the clear evidence that the Federal Government did not have, in the phrasing of *Brown Shoe*, "a definite purpose to enlarge the working capital of the company" by a free gift.

This lack of any real purpose to do here what the "community groups" did in *Brown Shoe* disposes of the "donated property" issue, in my opinion, and I need not elaborate my views on the defendant's alternative defense based on Mimeo 58 and the terms letter. On this point, too, I disagree with the court. Mimeo 58, which explicitly excludes donated property from straight-line depreciation, is entwined with the terms letter and forms an integral part of the mutual understanding for the change-over from retirement accounting. See *Chicago, Milwaukee, St. Paul & Pacific R.R.* v. *United States*, 186 Ct. Cl. 250, 266–272, 287–94, 404 F. 2d 960, 969–72 (1968). One of those accepted conditions was the exclusion of donated property. There was no change in the law "applicable to railroads in general" after plaintiff agreed to this condition. *Brown Shoe* did not initiate any such change; it applied the same general principle as *Detroit Edison*, but to a quite different factual situation.

Protective Work: Although the nature of the accounts in which plaintiff placed its protective work projects is not automatically binding for tax purposes, the character of those accounts does bear directly on the plaintiff's own view and treatment of the projects—and the plaintiff's own treatment is significant because, as the court says, "whether expenditures are currently deductible or must be capitalized depends on the purpose for which the expenditures are made." Here, plaintiff put the projects in capital accounts—separate from the assets (*e.g.* embankments) which they are now said to have repaired—thus suggesting that, in plaintiff's view, the purpose of the expenditures was not simply repair of the embankment (for example), but, rather, establishment of a new and independent capital asset with a depreciable life

of its own. Again, when plaintiff sought in the 1940's to change from the retirement system, the list of properties it furnished the Government as subject to depreciation covered the particular items now involved (this listing has special meaning because it obviously was for tax purposes).[3] Such continued treatment by plaintiff of the specific projects with which we are concerned in this issue, taken together with the pertinent information in the findings and record on the physical characteristics of the structures (*e.g.* retaining wall, culvert, steel pilings), persuade me that taxpayer's purpose in making the expenditures was not repair or maintenance of an existing structure but the creation of a new and independent structure. As the varying decisions in this crowded field indicate, there is no mechanical or physical test for deciding whether a piece of work is a repair of a larger asset or the addition of a smaller structure which is distinctively new and separate. That is why the taxpayer's own treatment seems to me so important as a prime guide through the tangle. I see no adequate reason for saying now that plaintiff's own historical attitude toward these expenditures was ill-conceived or incorrect.

Similarly, *Kansas City Southern Ry.* v. *United States*, 125 Ct. Cl. 287, 112 F. Supp. 164 (1953), looks quite different through my legal lenses. The physical nature of the work there, pole driving, was not comparable. In addition, that item was not included by the railroad in its depreciable properties for change-over from retirement accounting. The I.C.C. had itself acknowledged that the property should not have been included in a capital account, and this court recognized that reversal-of-position as showing that the original characterization as capital was wrong. 125 Ct. Cl. at 290, 293, 112 F. Supp. at 166. Thus, there was no such uniformity of treatment as there is here. On the contrary, when *Kansas City* was decided, the weightier view was that the item was expensible and not capital; and the taxpayer had not undertaken, as plaintiff did with respect to the items here (in its acceptance of the terms letter arrangement) to consider the property as capital and depreciable for tax purposes.

---

[3] As already mentioned in my discussion of "Donated Property Depreciation", *supra*, I do not agree with the court as to the effect of Mimeo 58 and the terms letter, or of the railroads' rights under that arrangement.

LARAMORE, *Judge*, joins the foregoing dissenting opinion on the "Protective Work Issue" but otherwise concurs in the PER CURIAM opinion of the court.

DURFEE, *Judge*, joins in the foregoing dissenting opinion on the "Donated Property Depreciation Issue" but otherwise concurs in the PER CURIAM opinion of the court.

NICHOLS, *Judge*, joins in the foregoing dissent with respect to the "Donated Property Depreciation Issue" and the "Protective Work Issue."

NICHOLS, *Judge*, dissenting in part:

I join in the opinion and judgment of the court, except as specified. Respectfully, I cannot subscribe to its treatment of the Mexican Tax Credit issue.

I start with the proposition that Mexicans live, as is their right, under a government and institutions that are different from ours, and no doubt better for them than ours would be. The Mexican statute established an income tax, but the Mexican authorities, by the agreement and findings, transformed it into something entirely different. We must assume and I do assume they did this lawfully, for American courts may not question the legality of acts of foreign officials in their own country. *American Banana Co.* v. *United Fruit Co.*, 213 U.S. 347 (1909) per Holmes, J.

What we have in reality is an agreement, that Mexico collects no tax and the Mexican railroads do not pay a per diem car rental in excess of that paid by United States and Canadian railroads. From the Mexican point of view, that is absolutely all. It is true they go through some paper legerdemain but that is only to accommodate these strange Norte Americanos. They assess a tax, so-called, of 100 percent of the so-called differential in the rentals, they purport to withhold it, and lo, the beneficent government in Mexico City grants the withholding to the railroad as a subsidy! The money never moves, but a non-tax becomes a tax, by virtue of this paper shuffling.

I am reminded of those mythical documents, known as invoices, which Hong Kong shopkeepers furnish to American tourists for the benefit, it is supposed, of American Customs.

North of the Rio Grande, there occurs the only result of this that has meaning. The United States railroad adds the

paper differential to its income, and will be taxed 52 cents on every dollar of it. But it takes the purported withholding as a tax credit and thus ends up with a saving of 48 cents of United States tax for every dollar of paper differential, up to the limits prescribed by the Internal Revenue Code of 1954 § 904, which prevent the credit from reducing the United States tax on income derived within the United States.

The presumption of the legality of Mexican official acts does not prevent us from having to determine that the so-called Mexican tax is either the substantial equivalent of an income tax as the term is used in the United States or is a tax in lieu thereof. *Missouri Pacific RR* v. *United States*, 183 Ct. Cl. 168, 392 F. 2d 592 (1968). Defendant says that it is not a tax at all if no money goes into the Mexican fisc. What is the Mexican fisc? The Mexican railroads being publicly owned, one may regard them as public instrumentalities and their fisc as part of the public fisc. We must take a broader view of these matters. I prefer to rely on the obvious intent of the framers of the agreement under review, that no money should change hands whatsoever. There is no reason to suppose, on the facts found, that the purported tax and purported subsidy have any recognition at all on the books of the Mexican government and Mexican railroads. Our commissioner notes no provision of law for subsidizing the Mexican railroads out of income tax receipts. This means that I would not, like defendant, include the paper differential in the railroad's gross income and allow the so-called tax as a cost deduction. I consider that this view is a concession that weakens the defendant's position without any necessity.

Also, it appears to me, the majority overlooks the salutory rule Mr. Justice Holmes laid down in the *American Banana Co.* case, *supra*. Mexican law decreed that Mexican officials levy an income tax, so we instinctively believe we must discover an income tax, or at least a tax in lieu thereof, somewhere in these proceedings. Were we confronted with the acts of United States federal officials, or those of a United States state official, this approach would be proper. We shy away from the obvious fact, that Mexico traded off the income tax

for a concession in the car rentals Mexican public-owned railroads paid United States railroads. But, as Holmes said at p. 358:

> * * * The very meaning of sovereignty is that the decree of the sovereign makes law. * * *

Thus, for us, the Mexican officials' measures are right because they took them, and we don't have to twist or distort their nature.

The remaining problem is a difficult one. Defendant has elaborated reasons why this court is not bound by its decision in *Missouri-Illinois RR Co.* v. *United States*, 180 Ct. Cl. 1179, 381 F. 2d 1001 (1967) in which we had under review the same agreement considered again here. Defendant argues that whether the railroad paid a tax is a fact finding, not committing the court by *stare decisis*. It says it was trapped in an unfortunate stipulation in the *Missouri-Illinois* case. The majority here is apparently enough impressed by this to consider the merits all over again. Interpreting a domestic contract would be a question of law. Here, really, we are interpreting a foreign contract. Our Rule 125 says that determination of foreign law is a legal question. This case illustrates how we trap ourselves in getting away from the old and sounder rule, that foreign law is a question of fact. Thinking, as I do, that we are concerned with what is in reality a tax exemption not a tax, I think the prior decision, whether fact or law, is so plainly wrong as to be within Item (a) of Judge Davis' tabulation, concurring in *Mississippi River Fuel Corp.* v. *United States*, 161 Ct. Cl. 237, 246, 314 F. 2d 953, 958 (1963) of reasons why we may reconsider one of our prior decisions. I feel trapped, too, and regret I was not astute enough to see the snare when I first stepped into it.

Findings of Fact

1. Plaintiff, the Chicago, Burlington & Quincy Railroad Company, is an Illinois corporation with its principal offices at 547 West Jackson Boulevard, Chicago, Illinois. Plaintiff is a common carrier by rail in interstate commerce subject to the jurisdiction of the Interstate Commerce Commission.

2. At all times here pertinent, plaintiff maintained its

books of account and filed its Federal income tax return on the accrual method of accounting and on the basis of the calendar year.

3. Plaintiff timely filed its Federal income tax return for 1955 with the District Director of Internal Revenue, Chicago, Illinois. Plaintiff paid income tax with interest for the year 1955 and obtained refunds to date, leaving net unrefunded taxes, all as follows:

Date of Payment	*Tax*	*Interest*
Sept. 15, 1955	$445,000.00	
Dec. 15, 1955	445,000.00	
Mar. 15, 1956	5,151,000.00	
June 15, 1956	4,799,051.48	
Aug. 15, 1957	305,480.18	$20,458.80
Refund	(256,349.64)	(17,168.40)
Refund	(2,756.83)	(184.63)
Totals	$10,886,425.19	$3,105.77

4. Plaintiff timely filed claims for refund with the District Director of Internal Revenue, Chicago, Illinois, as follows:

Date filed	*Issue*	*Amount*
Feb. 16, 1959	Protection Work	$63,349.88
Do	Casualty Loss	7,578.61
Do	Depreciation, Donated Property	26,784.30
Do	Excess Salvage	60,428.57
Do	Welded Rail	73,220.16
Apr. 14, 1959	1341 Computation	496,887.10

On May 27, 1963, the District Director disallowed plaintiff's claims.

5. Plaintiff is the sole owner of the claims here relied upon. No action on the claims has been taken by the Congress of the United States or by any department of the Government, except as noted above.

6. (a) Plaintiff's petition, filed May 7, 1965, raised issues relating to the six claims for refund noted in finding 4. In its answer, filed September 7, 1965, and first amended answer, filed October 24, 1967, defendant asserted, as setoffs, four defenses: (a) Mexican tax credit issue, (b) vacation pay accrual issue, (c) rail salvage value issue, and (d) § 1341 of the 1954 Internal Revenue Code computation issue. De-

fendant subsequently dropped its setoff defense under § 1341; and the parties agreed by pretrial stipulation that, with respect to the § 1341 issue raised in the petition, "* * * the amount of $490,315.14 may be accepted as the correct over payment under this issue." Accordingly, neither party has requested findings of fact with respect to the § 1341 issue. After trial, defendant conceded that plaintiff "is entitled to the recovery claimed under * * * [the excess salvage] issue." Thus, no findings of fact are necessary on that issue and plaintiff is entitled to recover with respect thereto. Remaining for resolution are seven issues: (a) donated property depreciation, (b) casualty loss, (c) welded rail, (d) rail salvage value, (e) protective work, (f) vacation pay accrual, and (g) Mexican tax credit.

(b) The parties have agreed that the amount of recovery to which plaintiff is entitled, if any, be reserved for determination by the parties after a decision on the merits of the several issues here in dispute, or for further proceedings under Rule 131(c), if necessary.

Donated Property Depreciation Issue

7. Prior to June 22, 1954, several states contributed to plaintiff various protective and safety facilities, and plaintiff carried them in its accounts, as noted below:

Jetties (Account 3)	$5,850.78
Bridges (Account 6)	52,870.24
Highway Undercrossings (Account 6)	1,475,533.30
Crossing Floodlights (Account 27)	1,635.58
Crossing Signals (Account 27)	543,540.00
Crossing Signs (Account 27)	3,701.24
Highway Overcrossings (Account 39)	63,009.39
Total	$2,146,140.53

The dollar figures above indicated and stipulated by the parties represent the adjusted tax basis for each item in the hands of the plaintiff at the time of acquisition. If plaintiff is entitled to depreciation deductions with respect to the above-noted items, the parties have agreed that the proper rate of straight-line depreciation to be applied to the total tax basis of the items is 2.29 percent for account 3; 2.14 per-

cent for account 6; 3.33 percent for account 27; and 2.65 percent for account 39.

8. (a) Starting about 1930, plaintiff entered into many agreements with various midwestern states relating to the facilities noted in finding 7. Though the agreements are not identical in terms, they provide in essence for construction of (a) highway overpasses and underpasses at highway-railroad intersections and (b) grade-crossing protection equipment, such as flashing-light signals and automatic gates. Generally, plaintiff agreed to perform the part of the construction work relating to railroad use, *i.e.*, bridges, track, signal lights, etc., and the states agreed to perform the part of the work relating to highway use, *i.e.*, roads for motor vehicles, approaches, etc. The parties agreed to share the expenses of the work, the states usually paying 50% or more of the total cost.

Pursuant to Federal Highway aid legislation (particularly acts passed in 1933 and 1944), the Federal Government agreed to pay the governmental share of the construction costs. Federal funds were allocated to the states to pay for specific construction projects agreed to by the states and the railroads. Under the Federal Aid Highway Act of 1944, 58 Stat. 839, ch. 626, costs were to be apportioned between the Government and the railroads, the railroads' share not to exceed 10 percent. In allocating funds, the fact that a railroad was making profits or losing money was not considered. Nor was there considered the need of the railroad for capital funds.

(b) Most of the agreements do not state expressly whether the respective state or the plaintiff has title to the facilities, though in some of the agreements plaintiff was given title *ab initio* to certain signal equipment. However, under all of the agreements, plaintiff was obligated to maintain, and replace at its own expense if needed, equipment originally furnished; and plaintiff could not arbitrarily remove equipment. Under all the agreements, plaintiff was required to maintain the facilities directly related to railroad use, such as bridges, roadbeds, track, etc., while the state was required to maintain the facilities directly related to motor-vehicle use, such as highways, approaches, etc. Some of the agreements

provided that in the event equipment was no longer needed at a particular location, plaintiff could remove it, subject to approval by the appropriate regulatory bodies, for relocation at other sites. Other agreements provided that equipment no longer needed was to become the property of the state for removal as appropriate, in which event plaintiff was relieved of its obligation for maintenance; and to the extent that plaintiff had replaced equipment at its own expense, such equipment was to be the property of plaintiff. Other agreements provided that if equipment was no longer needed at a particular location, the parties would negotiate regarding its removal and reinstallation elsewhere.

9. The facilities noted in finding 7 were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow. Plaintiff, however, received benefits from the facilities, among others, probable lower accident rates, reduced expenses of operating crossing facilities, and, where permitted, higher train speed limits, all of which permitted plaintiff to function more efficiently and presumably less expensively. The decision regarding what facilities to build and where to build them was made after negotiation between the respective states and plaintiff. Factors considered included the accident statistics of the crossing points and the need for improved motor-vehicle traffic flow. On projects done in the 1930's, there was also considered how many men could be put to work on a project since a principal goal of the Federal Government in giving financial support was to make work for persons unemployed during the economic depression. Another purpose of Federal financing was to curtail long-standing disputes between the states and the railroads concerning the prorata share each would pay for construction and improvement of such facilities.

10. (a) On February 5, 1943, plaintiff requested permission of the Internal Revenue Service (IRS) to change from retirement to depreciation accounting for road property. On April 12, 1943, the IRS responded by letter to plaintiff's request and enclosed a mimeographed form, called "Mimeo 58" and entitled "Change from Retirement to Depreciation Accounting for Road Property." Mimeo 58, undated and un-

signed, was prepared by the IRS for circulation to the railroads generally, many of which were seeking to change from retirement to depreciation accounting during World War II. Mimeo 58 sets out guidelines under which the changeover in accounting practice by the railroads would be acceptable to the IRS, and it describes information to be furnished by the railroads.

Plaintiff thereafter furnished to the IRS the required information which in essence constituted a list of properties subject to depreciation, their cost basis, salvage value, expired life, and estimated normal useful life; and on September 20, 1944, the IRS sent plaintiff a terms letter, incorporating the information supplied by plaintiff and some of the requirements set out in Mimeo 58. The terms letter granted plaintiff permission "to change from retirement to depreciation accounting as of January 1, 1943," to be effective "upon receipt of a letter agreeing to all the terms and conditions set forth herein." On April 20, 1945, plaintiff accepted the terms letter on the condition that "in the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise," plaintiff shall not be precluded "from the benefits of any such changes" and shall be "entitled to the benefit of any such changes regardless of the acceptance herein contained." Nothing in the record indicates that the IRS objected to or rejected plaintiff's condition of acceptance of the terms letter.

(b) Mimeo 58 stated, among other things, that with respect to property properly includable for depreciation purposes, "[d]onated property or contributions or grants in aid of construction from any source must be excluded." Such statement was not included in the terms letter of September 20, 1944. However, the schedules of plaintiff's property, submitted to the IRS in 1944 for which straight-line depreciation was requested, did not include the donated property listed in finding 7.

(c) On May 1, 1961, plaintiff submitted to the IRS revised schedules for depreciable roadway property and requested the benefit of section 94 of the Technical Amendments Act of 1958 (also known as the Retirement-Straight Line Adjustment Act of 1958, Pub. L. No. 85–866, 72 Stat. 1606). On July

26, 1961, the IRS responded to plaintiff's request, noting the earlier terms letter of September 20, 1944, and stating that plaintiff's revised schedules were acceptable effective January 1, 1956, "provided a timely election has been made under section 94." Earlier, December 14, 1959, plaintiff had irrevocably elected to have section 94 of the above-noted act "apply to the determination of its Federal tax liability for all applicable years." The revised schedules of depreciable property submitted by plaintiff to the IRS in 1961 did not include the donated property listed in finding 7.

Casualty Loss Issue

11. During the taxable year 1955, 13 freight cars owned by plaintiff, and being capital assets used in its business, were destroyed by accidents while on lines of other railroads. The original cost to plaintiff for the cars was $76,007.30. The monies paid to plaintiff as compensation for the loss was $83,186.35. The total of amortization and depreciation accrued to the date of loss was $36,886.58, the basis of the property at the time of loss thus being $39,120.72. Plaintiff therefore realized a gain of $44,065.63. Part of the amortization was accrued under § 124A of the 1939 Internal Revenue Code, and a further part of § 168 of the 1954 Internal Revenue Code. The amortization was so-called rapid amortization for emergency facilities, taken in lieu of the usual ratable depreciation used to compute Federal income tax. The excess of amortization accrued against the loss over normal straight-line depreciation was $28,639.22. The freight cars were properly subject to allowance for amortization and depreciation; and at the time of their destruction, they had been held by plaintiff for more than 6 months.

Welded Rail Issue

12. During 1955 and at all other material times, plaintiff used the retirement-replacement-betterment method of accounting for its track accounts and, in particular, for its rail and joint materials (angle bars, bolts and washers). Retirement-replacement-betterment accounting is recognized by the Commissioner of Internal Revenue to be a proper method

for determining depreciation. Under this method, as used by plaintiff, no ratable annual depreciation deduction is taken with respect to a particular asset. Rather, a deduction for the total original cost of the asset is taken upon the asset's ultimate retirement. The total of such deductions in a tax year represents the depreciation deduction with respect to all items accounted for under the method for that year.

In detail, the retirement-replacement-betterment method of accounting, as used by plaintiff, works as below outlined. All assets subject to the method are carried on plaintiff's books at stated values. When a particular asset, such as a section of rail, is retired from service without being replaced, its stated value on plaintiff's books is charged to current expense. The retired asset is then assigned a value on plaintiff's books (as reusable rail or as scrap) and such value is credited to (and thus reduces) current expense. If an asset is replaced in kind (rather than simply retired), the cost of the replacement is charged to current expense and the assigned value of the replaced rail is credited to (and thus reduces) current expense. If the rail laid in replacement is new, its cost as new rail is expensed. If the rail laid in replacement is used rail, the amount expensed is the value of the used rail as carried on plaintiff's books. Thus, *e.g.*, if 80-pound rail is replaced by 80-pound rail, the cost of the replacement is expensed and the value assigned to the replaced rail (as scrap or reusable rail) is credited to (thus reducing) current expense.

In the case of replacement of rail with heavier rail (a betterment), the current cost of the betterment portion is capitalized, while the current cost of the replacement portion is expensed. *E.g.*, if 80-pound rail is replaced with 100-pound rail, the current cost of the replacement in kind, *i.e.*, 80-pound rail, is expensed, while the excess of the cost over the cost of replacement by 80-pound rail is capitalized as a betterment. If the 100-pound rail laid in replacement is used-rail taken from plaintiff's inventory, the value previously assigned to it (*i.e.*, when placed in inventory) is the "cost" used to determine the 80-percent expense and 20-percent capitalize amounts. If, on the other hand, the 100-pound rail is new rail, its cost as new rail is the basis for the 80-percent and 20-percent apportionment.

13. In 1955, plaintiff replaced a number of 39-foot lengths of steel rail with 78-foot lengths of heavier rail. The standard length of rail purchased from steel mills was 39 feet. Plaintiff welded together two standard lengths to make the replacements. The total cost for welding such rails in 1955 was $155,748. The portion of the welding cost allocable to the increase in weight of the new rail was $14,940 and it was capitalized, in accordance with plaintiff's accounting practice noted in finding 12. The portion of the welding cost allocable to the same weight as the replaced rail was $140,808 and it was expensed, in accordance with plaintiff's accounting practice noted in finding 12. The average cost of welding rail in 1955 was $11.83 per weld, while the cost of joining two rails with angle bars and bolts was about $10 ($9.81 for 112-pound rail; $10.39 for 129-pound rail). In the welding process, no material is added to the rail. In fact, about ⅞″ is lost off each end of the rail, at the point of the weld, since the rail ends are fused together under pressure without adding material, thus creating a bead of raised metal at the joint; and the joint must be ground down to eliminate the bead, thereby removing some material.

14. On its books of account, plaintiff treated the cost of replacing bolted rail with welded rail as follows:

(a) The portion of the welding cost attributable to replacements of track in kind was expensed; and the portion attributable to higher-weight rail was capitalized;

(b) the original cost of the replaced joint materials (angle bars, bolts and washers), which cost had been capitalized when the joint was originally installed, was charged to current expense as a retirement; and

(c) nothing was entered on the books of account as a capital item to replace the cost of the retired joint materials except the portion of the welding cost attributable to higher-weight rail.

15. The conventional way of fastening together the ends of rail in a track system is by bolted joints. Bolted joints comprise a pair of angle bars which bridge the rail ends across the rails' web and are fastened to the web by six bolts and washers. Bolted joints tend to come loose with wear and require maintenance to tighten them. If not tightened, the rail ends

move up and down under the load of rolling stock, which batters and laminates the rail ends (called primary batter) and loosens the ties and tie plates. Furthermore, when the ties move up and down, the ballast under the ties becomes pulverized, water enters forming puddles, and the track is made insecure. Maintenance of conventionally bolted rail includes tightening up the bolts the first year after installation and generally each two years thereafter. About every 12–14 years, it is sometimes necessary to remove old bolts and replace them with new bolts. Primary batter, which results in depressions at the rail ends, is corrected by adding weld metal at the depression. The practice is to correct primary batter when the depression is between 0.030 and 0.040 inches. If the depression exceeds 0.060 inches, the rail ends must be cropped and rejoined.

16. Plaintiff first installed welded rail in some of its track lines in 1955, with the expectation that welded joints would prolong rail life and eliminate, or at least substantially reduce, maintenance. Welded joints, unlike bolted joints, do not require bolt tightening and repair as noted in finding 15. Savings in rail maintenance labor to date is estimated to be about 40–50 percent. The railroads, including plaintiff, are continuing to install and use welded rails. Though some cracked welds have required service, no maintenance of welded joints has been required to date, other than what is necessary on the rail lines themselves.

17. Though welded joints installed since 1955 have required no maintenance comparable to bolted joints, a phenomenon called secondary batter first became serious in 1967 and will require maintenance in the near future. Secondary batter results from the fact that the fused metal at welded joints is harder than the rail metal on either side of a joint. Thus, the joint wears less rapidly than the main rail. After extensive use and track wear, the metal adjacent either side of the weld tends to dish out as the wheels of railroad cars ride over the weld, *i.e.*, the wheels tend to batter the track downstream of the weld. Furthermore, secondary batter is aggravated if the weld is not ground down initially to the level of the rail ends on either side of the weld. If not properly ground down, the wheels of railroad cars ride up over the

weld and drop down on the other side of the weld, thus accelerating dishing out. Secondary batter becomes progressively worse with time and particularly if trains run in both directions on the track. Good engineering practice requires that secondary batter, like primary batter, be corrected when the depressions reach a depth of about 0.030–0.040 inches. In 1967, some of plaintiff's main lines, with welded joints installed in 1955, showed secondary batter of about 0.025–0.039 inches.

Correction of secondary batter will require grinding down the weld and track to eliminate dished out areas, or, in extreme cases, cropping out the damaged areas and rewelding the rail ends. Up to 1968, plaintiff had taken no maintenance steps to correct secondary batter, even on welded rail installed as early as 1955. However, because of the uncertainties created by problems of secondary batter and because substantial correction will be needed in the near future, it is not clear on this record whether the long-term costs of maintaining welded rail will be substantially less than bolted rail. The useful life of rail is 40–50 years, during which the rail is picked up from time to time and relaid at other track locations. Because useful life is principally a function of the quality and extent of use of the rail itself, the record does not establish that rail with welded joints will have a useful life longer than rail with bolted joints, except that it is reasonable to infer from the evidence that, properly maintained, welded rail will require less cropping over its years of use than bolted rail.

Rail Salvage Value Issue

18. Secondhand, or used, rail is rail that has been picked up or recovered by plaintiff from one line of its track and is in sufficiently good condition to be relaid later in another line of track. Scrap rail is rail which has been picked up or recovered and has no remaining usefulness to plaintiff as rail. It is sold to the highest bidder as scrap metal. In accounting for secondhand rail when picked up or relaid, plaintiff used retirement-replacement-betterment accounting, as described in finding 12. Since about 1920, and including 1955, plaintiff has consistently assigned a value of $25 per gross ton ($22.32

per net ton) to the secondhand rail recovered from replacements or betterments, and has assigned a value of $20 per gross ton ($17.86 per net ton) for scrap rail. In 1955, plaintiff purchased new rail at an average of $93.70 per net ton. In 1955, plaintiff's average original investment cost, for all rail in use, was $43 per net ton. In 1955, plaintiff realized $49 per gross ton ($43.75 per net ton) from the sale of rail as scrap, and plaintiff reported and paid tax on income arising from the sale of rail as scrap.

19. Secondhand rail, which is capable of reuse, is of greater utility and value than rail which is fit only for sale as scrap. Plaintiff does not sell as scrap any rail that is reusable because of the shortage of rail for industry-track and branch-line uses.

20. In its program for replacing rail in its track lines from time to time, plaintiff customarily lays heavier-weight sections to replace rail of lighter weight. Rail released from main rail lines is usually taken up and relaid on a branch line or a secondary line; and, in turn, rail taken up from secondary lines or branch lines is usually relaid in yard tracks or industry tracks. For example, heavy rail, such as 136-pound rail, laid on plaintiff's main line, is generally used in four cycles before its useful life is completed and it becomes scrap. Thus, rail released from the main line usually is reused three times—in a secondary line, then in a lighter branch line, and finally in yard tracks or industry tracks. Relay rail is classified according to weight and condition so to determine its suitability for reuse. Generally, rail that is recovered and reusable as secondhand rail is relaid within a year. At times, however, reusable rail remains in plaintiff's inventory for more than a year.

The service life of rail, from the date first installed until picked up and sold as scrap, is between 40 and 50 years. The average age of rail in plaintiff's main-line tracks at the time it is replaced is 22.69 years.

21. In 1955, plaintiff laid in replacement 58,529 net tons of rail, of which 40,276 net tons were new rail and 18,253 net tons were secondhand rail. The 40,276 net tons of new rail cost $3,828,545, of which $536,847 was capitalized as betterments (representing 5,648 net tons), and $3,291,698 was expensed as replacements (representing 34,628 net tons).

Of the 18,253 net tons of secondhand rail laid, 2,255 net tons were capitalized as betterments, at an assigned value of $22.32 per net ton (total $50,359); and 15,998 net tons were expensed as replacements, at an assigned value of $22.32 per net ton (total, $357,196). Plaintiff in 1955 picked up 50,626 net tons of rail, the value of which was credited to (thus reducing) operating expense. The value of rail picked up was $1,004,077, attributable to 22,398 net tons classified as secondhand rail (valued at $22.32 per net ton, thus $499,988), and 28,228 net tons classified as scrap (valued at $17.85 per net ton, thus $504,089).

In sum, considering the debits and credits to operating expense for rail relaid and rail picked up, the result was a net charge to operating expense of $2,644,817, constituting the cost of rail laid in replacement ($3,291,698 plus $357,196), less the assigned value of the rail picked up ($499,988 plus $504,089).

In 1955, plaintiff added 839 net tons of rail in new lines and extensions. Of the 839 net tons, 12 net tons were new rail (total cost, $1,202) and 827 net tons were secondhand rail, carrying an assigned value of $22.32 per net ton (total cost, $18,455). Such costs were capitalized.

22. The use of an assigned value (or salvage value) for recovered rail, which value reduces the aggregate charges to operating expense for replacements and retirements without replacement, is an integral part of retirement-replacement-betterment accounting, as employed by plaintiff.

23. Rail picked up by plaintiff in 1955 and classified as scrap was assigned a value of $17.85 per net ton. The total amount so-valued was accounted for by reducing operating expenses (as noted in finding 21) and increasing the inventory (material and supplies) account. When the scrap was later sold (at higher than $17.85 per net ton), the difference between the assigned value ($17.85 per net ton) and the selling price ($43.75 per net ton) was treated as income. Generally and in 1955, plaintiff sold scrap rail almost immediately after pickup.

24. Plaintiff sometimes sells secondhand rail to industry users for laying as connecting track to operating rail lines. Generally, the industry concerned is charged a flat rate per foot of track laid. In 1955 plaintiff's charges for industry

rail laid were about 60 percent of the price of new rail. Sometimes, plaintiff refunds part of charges, based on the extent of use of track by the industrial user.

25. The average price (per net ton) paid by plaintiff for new rail from 1919 to 1961 is as follows:

1919	$35.83	1941	$36.84
1920	42.08	1942	36.74
1921	-----	1943	36.90
1922	36.64	1944	38.35
1923	36.93	1945	36.48
1924	39.08	1946	44.95
1925	38.61	1947	53.64
1926	38.62	1948	61.62
1927	40.40	1949	69.00
1928	40.12	1950	73.00
1929	40.00	1951	73.00
1930	40.02	1952	76.50
1931	38.79	1953	88.00
1932	36.47	1954	90.50
1933	36.41	1955	93.70
1934	33.06	1956	97.37
1935	32.94	1957	105.50
1936	31.85	1958	116.50
1937	38.71	1959	116.50
1938	38.10	1960	-----
1939	36.84	1961	116.50
1940	36.71		

26. Under retirement-replacement-betterment accounting, plaintiff's capital accounts for rail and joint materials reflect the original cost of the first assets installed, and the betterment portion of subsequent replacements, but all replacements (and the replacement portion of betterments) are expensed. The result is that plaintiff's capital account for rail and joint materials is a residuum of original costs, and does not reflect current costs, except to the extent of the current cost of betterments. Principal reasons for using retirement-replacement-betterment accounting are ease of recordkeeping for an account with many assets which are repeatedly replaced, and compliance with the accounting methods set forth in the Uniform System of Accounts for Railroad Companies prescribed by the Interstate Commerce Commission. A result of using retirement-replacement-betterment accounting (com-

bined with the rising cost of rail after World War II) is that the railroads' track accounts today are between one-third and one-half of what they would be, based on the cost of the rail actually in place.

27. Other railroads used assigned values for secondhand rail in 1955 which differed from plaintiff's value of $25 per gross ton ($22.32 per net ton). For example, the Baltimore & Ohio Railroad Company used a value of $43.76 per net ton, the Pennsylvania Railroad Company used $54.09 per net ton, and the Chicago and Northwestern Railroad Company used $63.34 per net ton. Other railroads used values comparable to or lower than plaintiff's.

28. In 1964, pursuant to a request by plaintiff, the national office of the Internal Revenue Service issued a letter of technical advice which called for valuation of plaintiff's secondhand rail at fair market value or cost, whichever is lower. In 1967, Rev. Rul. 67–145, 1967–1 Cum. Bull. 54, was issued, which required utilization solely of "fair market value" in the valuation of plaintiff's secondhand rail. Rev. Proc. 68–46, 1968–2 Cum. Bull. 961, requires that "fair market value" for a year in question be determined by "averaging the new and scrap prices" for rail in that year.

Protective Work Issue

29. In 1955, plaintiff carried out 28 construction projects (total cost: $121,026.70) directed to protecting and maintaining its track facilities near waterways. The work was generally of five types: (a) channel and waterway diversion, (b) construction of dikes, dams and jetties, (c) grade raisings, (d) riprap and bank protection, and (e) bridge and culvert extensions or modifications.

(a) One project related to channel and waterway diversion. A creek which ran along plaintiff's track embankment at Dudley, Iowa, had changed course and was eroding away the embankment soil. To arrest the erosion, the creek channel was straightened so to divert the waterflow away from the embankment. Earlier attempts to arrest erosion by use of riprap were unsuccessful.

(b) Six projects related to construction of dikes, dams and jetties. Five of them involved building rock-filled timber

cribs, steel jetties and, in one instance, a retaining wall, in streams or rivers to deflect waterflow away from plaintiff's track embankments, thereby to prevent further erosion of the embankments. One of the projects involved placing an earth blanket over seepage points in a levee to protect the levee and and a railroad bridge during high water of the Des Moines River. A typical example is construction done at Aurora, Illinois, where a highway bridge, maintained by plaintiff, crossed over the Indian Creek River. Plaintiff's right-of-way ran alongside the southerly lower bank of the river. As originally constructed, the northern approach to the bridge was grounded on the top of the natural river bank, without any retaining wall. Shortly before 1955, the Indian Creek River changed its course and began to cut against the northerly bank, threatening to undermine the approach and the bridge. To meet the problem, plaintiff placed 43-foot steel sheet piles around the river pier of the bridge and built a permanent retaining wall along the northern bank about 15 feet high and 140 feet long (cost: $12,082.86).

(c) One project related to grade raising. A railroad bridge over the Mississippi River, north of Canton, Missouri, was raised to allow passage thereunder of drift during heavy rains. The river had silted up near the bridge, thus raising its bed. Silting up occurred because a dam was built upstream which changed the waterflow velocity and pattern in the river. The accumulation of drift threatened the integrity of the bridge.

(d) Two projects related to riprap and bank protection. In both projects, riprap was placed along the banks of a river or creek to slow down and divert waterflow and arrest further erosion and deterioration of rail embankments.

(e) Eighteen of the projects related to bridge and culvert extensions or replacements. In general, the projects involved modification of existing culverts, trestles, walls, and pipes to alter or divert waterflow which was eroding and endangering rail lines and embankments. In some instances, new culverts, trestles, walls, or pipes were installed near existing facilities of a like nature in order to accommodate changed overflow patterns which threatened the integrity of the embankments.

30. The Commissioner of Internal Revenue disallowed as business expenses the cost of the projects noted in finding 29.

31. Railroad embankments have an indefinite service life. Unless attacked by outside forces, they remain in serviceable condition so long as the railroad operates trains over its rail lines. Embankments near waterways are built originally by plaintiff using good engineering practices to provide permanent protection against water erosion. However, unforeseen and unforeseeable changes in waterflow patterns near the embankments sometimes require remedial steps to arrest erosion. It is not possible to predict when remedial steps will be necessary. Plaintiff is engaged in a continuous program of inspection and evaluation of damage to its embankments. When necessary to correct deterioration, the steps taken are intended to arrest the problem and prevent a premature end to the service life of the embankment. The nature of the corrective work done depends upon the severity of damage and the possibility of continued damage. The work is done in the simplest and cheapest manner under the circumstances to insure an end to the particular erosion problem and to keep the rail line in safe operating condition. None of the work here in issue increased the original service life or value of the embankments but rather prevented a premature end to such service life.

Vacation Pay Accrual Issue

32. In 1955, plaintiff accrued and took as a deduction on its Federal income tax return an amount estimated to be its liability for vested vacation pay earned by its employees in 1955 and payable in 1956. Because plaintiff did not know how much it would in fact pay out in 1956 for vacation liability accrued in 1955, it had to estimate its liability on the basis of past experience.

33. Prior to 1955, plaintiff used the following method to estimate its vacation pay liability accrued during a given year: To calculate its accrued liability, say for 1952 as an example, plaintiff first determined the actual payments made to its employees in 1952 (for vacation pay liability accrued in 1951). The amount of actual payments made in 1952 was

then adjusted for any prospective salary changes, changes in employees' vacation brackets, or prospective changes in employment status, and the adjusted figure became the estimated liability for 1952 (to be paid out in 1953). As a hypothetical and simplified example, if plaintiff actually paid out in 1952 (for vacations accrued in 1951) the sum of $5,000,000, and a 3-percent wage increase was effective in 1952 (with no prospective changes in vacation brackets or employee status), then plaintiff would estimate its accrued liability for 1952 to be $5,000,000, plus 3 percent of $5,000,000 ($150,000), or a total of $5,150,000. If subsequent experience in 1953 resulted in payment of more or less than $5,150,000, then the next year's estimate was adjusted accordingly.

Following the above example one step further, the tax deduction taken for 1952 would be $5,150,000, adjusted by an amount to compensate for any difference between what was actually paid in 1952 ($5,000,000) and the actual deduction taken in 1951. Thus, if the deduction for 1951 was $5,500,000 ($500,000 more than was subsequently paid out in 1952), the deduction for 1952 would be correspondingly reduced, *i.e.*, $5,150,000 less $500,000, or $4,650,000.

34. (a) Starting in 1955, plaintiff changed its method of estimating accrued vacation pay liability. Although plaintiff maintained its books of account on the basis of the calendar year, it closed its books for vacation pay liability purposes at the end of the first 10 months of 1955. Thus, plaintiff did not calculate the payments made for vacations taken during the last 2 months of 1955. Rather, plaintiff estimated the payments made during the last 2 months of 1955 by looking back to the actual payments made in 1954. In 1954, 19.69 percent of all vacation payments for the whole year were made in the last 2 months; therefore, plaintiff assumed the same percentage would prevail in 1955. Plaintiff's accrued liability for 1955 was thus calculated by summing up three figures: the actual payments made in the first 10 months of 1955; 19.69 percent of that amount;[1] and any adjustments for wage increases, etc., in 1955. The total figure then became the estimated accrued liability for 1955, to be paid out in 1956.

---

[1] The estimate for the last 2 months was incorrectly calculated by plaintiff. It should be 19.69 percent of an amount which is equal to the actual payments made in the first 10 months, divided by (1–0.1969). See n. 2, *infra*.

(b) In a letter to the Internal Revenue Service dated June 8, 1962, plaintiff made the following explanation of why it changed its method of estimating accrued vacation pay liability for 1955:

* * * * *

Prior to 1954 vacation pay liability was not accrued in the books of account, being accrued for tax purposes only. It was therefore possible at times to make estimates after the accounts were closed for the year, making for greater accuracy. For example, the estimate for vacation pay liability for the year 1948 was not made until March 1949 and the actual amount of $2,602,666 was available.

Beginning in the year 1954 vacation pay liability has been accrued in the books of account making it necessary to base the accrual on information available at the time the books are closed. This results in some variance between estimates and actual payments in the following years.

* * * * *

35. Based on the method outlined in finding 34(a), plaintiff estimated it would pay out in 1956, $5,544,003.52 for vacation time taken (calculated by summing (a) $4,372,-649.93, the amount actually paid out in the first 10 months of 1955, (b) $860,974.77, which is 19.69 percent of $4,372-649.93,[2] and (c) $310,378.82, representing wage increases in 1955). In fact, plaintiff paid out, in 1955, $4,926,897, which is $306,727.70 less than the sum of (a) and (b) above. Plaintiff's tax return for 1955 was filed June 15, 1956, and plaintiff was on the accrual method of accounting for the calendar year. Plaintiff therefore knew, or should have known, the exact amount paid out for vacations in 1955 ($4,926,897) before it filed the 1955 return since, under calendar-year accounting, the books were closed on December 31, 1955; and therefore it was unnecessary for plaintiff to make an estimate for item (b) above.

36. The deduction claimed on plaintiff's 1955 tax return for liability for accrued vacation pay was $5,405,201. The amount actually paid out for vacations in 1956 was $5,116,-219, a difference of about 5.3 percent.

---

[2] As noted in n. 1 (finding 34), the correct calculation should have been 19.69 percent of $4,372,649.93/(1–0.1969), which is about $1,070,000, rather than $860,974.77.

Mexican Tax Credit Issue

37. In 1955, certain rolling stock owned by plaintiff was operated by Mexican railroads over lines located in Mexico. Plaintiff received rental payments from the Mexican railroads for their use of its rolling stock.

38. The Association of American Railroads (AAR) sets per diem rental rates for freight cars which are operated off the line owning the car and on other railroad lines. The freight car per diem rate for 1955 was $2.40, which was the amount that one United States or Canadian railroad paid another United States or Canadian railroad for each calendar day a freight car owned by the second railroad remained on the first railroad's lines. The per diem rate paid by the Mexican railroads in 1955 for use of American freight cars was $3.40, of which $1.00 was withheld by the Mexican railroads as payment for tax due the Mexican Government and $2.40 was paid to the American railroad whose cars were used. For 1955, plaintiff claims payment of taxes to Mexico of $85,656.87, for which it claims a tax credit of $74,767.97 under §§ 901–904 of the Internal Revenue Code for 1954.

39. The facts relating to the Mexican income tax law and its relationship to per diem charges for the use by Mexican railroads of American freight cars are set out in findings 12 through 20, 24, 25, 27, 28, and 31, in *Missouri-Illinois R.R.* v. *United States*, 180 Ct. Cl. 1179, 381 F. 2d 1001 (1967). The evidence in this case is fully consistent with those findings; and for convenience they are set out below, substantially verbatim, as findings 40 through 53, the only significant changes being those necessary to reflect the tax year here in issue and the fact of a different plaintiff.

40. In the past the practice had been for a Mexican railroad which used a car of United States or Canadian ownership to pay to the car owner the Mexican per diem rate minus a percentage of that rate (usually 10 percent) which it was required to withhold under the Mexican income tax law. The amount withheld by the Mexican railroad was turned over to the Mexican treasury, and the United States or Canadian car owner received credit for the tax payment. At the end of the taxable year, Messrs. Basham, Ringe & Correa, a firm of attorneys in Mexico City, filed a Mexican income tax re-

turn on behalf of the car owner, and the car owner paid the difference between the amount withheld by the Mexican railroad and the full amount for which it was liable under the graduated income tax scale.

41. On December 31, 1953, a new Mexican federal income tax law was published which took effect on January 1, 1954.

42. This Mexican statute, entitled "Ley del Impuesto Sobre la Renta" (which in English is "Income Tax Law"), was applicable to the rentals earned by the plaintiff in Mexico in 1955.

43. Schedule VI of this Mexican statute (entitled "Imposition of Capital"), in part imposes a tax on income derived from:

> XIV.—Rentals, prizes, royalties and retributions of all kinds which are received as owners or holders of personal property or of rolling stock from the persons to whom they grant the use or exploitation of the same without transferring the ownership thereof.

Under Article 129th, the lessor of rolling stock is entitled to certain deductions. However, paragraph XIV provides that those taxpayers to which paragraph III of Article 6th refers, who receive income for any of the reasons set forth in paragraph XIV, shall pay the tax in Schedule I. The plaintiff is a taxpayer within paragraph III of Article 6th. Schedule I provides in Article 26th that the basis of the tax in said schedule shall be the taxable profit which is the difference between the income received by the taxpayer during a period and the deductions authorized by the law. Article 28th of Schedule I provides that when because of the nature and characteristics of the operations carried out by the taxpayer it is not possible, by ordinary procedures, to determine with exactness the taxable income, the department of the treasury may enter into agreements for the determination of the tax base.

44. Under Schedule I of the Mexican statute, deductions are permitted which are very similar to deductions in the United States statute.

45. The Mexican treasury department considered that it was difficult to determine the taxable income of the foreign companies leasing rolling stock into Mexico and to check and

verify the expenses and taxable income of these companies. Therefore, the Mexican Government decided to enter into agreements, under Article 28 of the income tax law, for the payment of the tax.

46. On December 31, 1954, an agreement was executed by representatives of United States and Canadian railroads, of the Government of Mexico and of the Government-owned railways of Mexico, with respect to the payment of the tax on the income received by the United States and Canadian railroads from Mexican railroads. This agreement recited that certain United States and Canadian railroads (including the plaintiff herein) received income from sources located in the Republic of Mexico from the rental of rolling stock to the National Railways of Mexico and the Mexican Railway, which income was held to be subject to the Mexican income tax law. The agreement thereafter provided that the income received from the rental of rolling stock while in the Republic of Mexico, by the United States and Canadian railroads which do not operate in Mexico through agencies or branches, was subject to payment of Mexican income tax under Schedule VI of the income tax law; that the Mexican railways were authorized and obligated to retain the tax for which the United States and Canadian railroads were liable, and to account to the Mexican treasury for the amount so retained; that the amounts retained shall be equal to the tax due; that the payment of the amounts so retained, to the Mexican Government, would be in full satisfaction of the obligations of the United States and Canadian railroads for Mexican income taxes on the rolling stock rentals; that each United States and Canadian railroad was obligated to file an income tax return setting forth all income from the Mexican railroads for the rental of rolling stock and the total Mexican income tax due thereon, and that the department of the treasury and public credit of the Republic of Mexico agreed that the retention of the difference between the basic per diem rate and the Mexican per diem rate would fully satisfy the obligations of each of the United States and Canadian railroads for Mexican income taxes on rolling stock rentals. A similar agreement was executed July 18, 1955, covering rentals received from some of the privately owned railroads in Mexico.

These privately owned lines constitute a very small part of the railroads in Mexico, with the main railroads being agencies of the Mexican Government.

47. The agreement, referred to in the preceding finding, was executed by representatives of United States and Canadian railroads, the Government of Mexico and the National Railways of Mexico and Mexican Railway, relating to the manner of payment of the income tax obligations of the United States and Canadian railroads (including the plaintiff). Its signatories were W. T. Faricy, President of the American Association of Railroads (on behalf of American and Canadian railroads), the Minister of Finance and Public Credit (on behalf of the Government of Mexico), and the General Manager (on behalf of the National Railways of Mexico and Mexican Railway, which were Government-owned). Faricy signed the agreement on October 6, 1954, and the Mexican officials signed it on December 31, 1954. A correct translation of the full text of the agreement, omitting the declarations as to its execution and signatures, is as follows:

> AGREEMENT reached on one part by the Ministry of Finance and Public Credit, represented by the Minister himself Lic. Antonio Carillo Flores, the American and Canadian Railroads mentioned in enclosure "A", [which list includes plaintiff here] represented by Mr. W. T. Faricy,—President of the Association of American Railroads, and the—National Railways of Mexico and Mexican Railway, represented by the General Manager, Licendiado Roberto Amoros, with a view to outline the basis to determine and withhold the income tax payments derived from revenues received through rental of—American and Canadian rolling stock while in the Republic of Mexico.
>
> STATEMENT
>
> Some American and Canadian Railroads receive revenues from sources located in the Republic of Mexico through renting of rolling stock to the National Railways of Mexico and Mexican Railway, said revenue now subject to the Income Tax Law in Mexico.
>
> The Code of Rules on Per-Diem of Freight is outlined in—Circular No. T-225, its supplements and reis-

sues, published by the Association of American Railroads. This Code, in Rule 1, establishes the rate for the use of freight cars which is to be paid for each natural day, and in the future these rates will be called "Per-Diem Basic Rates". Note No. 1 of Rule 1 establishes the per-diem rate for the use of freight cars of American and Canadian ownership while in the Republic of Mexico. This rate, in the future, will be called "Mexican Per-Diem Rate", which is higher than the basic Per-Diem rate, which difference consists of the amount of the Mexican Income Tax due through revenues for account of rental of rolling stock, which the owners need to pay to the Mexican Government.

Article 201 of the Law decrees the obligation to withhold and pay the accrued tax to persons making payments to subjects of—the tax located abroad from revenues that are taxable under said Law.

With authority provided for in Article 28 of the Income Tax Law and with a view to comply with the tax payment accrued through the rental of rolling stock, this Agreement is reached with the—following provisions:

CLAUSES:

1. The revenue received by American and Canadian Railroads not operating in Mexico through agencies or branches derived from rental of rolling stock while in the Republic of Mexico, is subject to the payment of income tax, as per Item VI.

2. The National Railways of Mexico and Mexican Railway, with authority provided for in Article 201 of the Income Tax Law, are—compelled to withhold the tax accrued by the American and Canadian-Railroads on payments derived from rental of rolling stock while in the Republic of Mexico. The withholding is to be made on the total of the tax accrued and, therefore, the American and Canadian Railroads are exempt from the obligation decreed in Article 169 of—Rulings of the Income Tax Law, which in essence is the payment of the tax through the cancellation of stamps on receipts issued to—the National Railways of Mexico and Mexican Railway for taxes derived from the rental of rolling stock while in the Republic of Mexico.

3. The National Railways of Mexico and Mexican Railway agree to pay without discounts to each of the American and Canadian Railroads listed on enclosure "A" signed by each party and included in this—Agreement, the basic Per-Diem rate in effect at the time it is

due, to retain the difference between the basic Per-Diem rate and the Mexican Per-Diem rate, and to pay the amounts withheld to the Mexican Government as the total obligations of the American and Canadian Railroads, in accordance with the Income Tax Law of Mexico regarding the rental of rolling stock.

4. The American and Canadian Railroads are to file with the Ministry of Finance and Public Credit during the month of January of each year a declaration of Income Tax earned the previous year, wherein all of the revenues received by the Mexican Railroads through the rental of rolling stock are to be mentioned and the total of the tax due on same.

5. It is agreed that the declarations of Income Tax filed individually by the American and Canadian Railroads listed on enclosure "A", will include a statement of the total of the taxes mentioned as earned and withheld by the National Railways of Mexico and Mexican Railway, in accordance with Articles 201 and 28 of the Income Tax Law of Mexico. It is also agreed that the revenue for the rental of rolling stock mentioned in said declarations will be computed at the basis of the Mexican Per-Diem rate.

6. The Ministry of Finance and Public Credit of the Republic of Mexico agrees that the withholding of the difference between the Basic Per-Diem rate and the Mexican Per-Diem rate mentioned in—Clause 3, will cover completely all obligations of each of the American and Canadian Railroads listed on enclosure "A" of the Income Tax Law of Mexico on rental of rolling stock. The Ministry agrees, in addition, to furnish to each of the American and Canadian Railroads through a receipt or other form, a statement certifying said obligations.

7. The Ministry of Finance and Public credit will grant the National Railways of Mexico and the Mexican Railway for as long as—this obligation of payment of tax on rental of rolling stock exists, a subsidy equal to the amount of taxes withheld.

8. It is expressly agreed that in the case when some of the American or Canadian Railroads forming part of this agreement withdraw from same, said railroad or railroads will have the right to do it through advance notice in writing, stating its determination, 60-days in advance, to the Association of American Railroads, the Ministry of Finance and Public Credit of the Republic of Mexico and—the National Railways of Mexico and Mexican Railway, with the understanding that this will

not destroy the other portions of this agreement, which will continue in effect.

9. It is expressly agreed that the Agreement will have a retroactive character to January 1954, in view of the fact that negotiations between all parties took place from that—date when actually the Agreement was put into effect.

* * * * *

48. On July 18, 1955, a similar agreement was signed by Faricy on behalf of the United States and Canadian railroads and the Minister of Finance and Public Credit of Mexico relating to the manner of payment of the Mexican income tax on the income received from the lease of rolling stock to four privately owned Mexican railway firms.

49. The tax withheld by the Mexican railroads which were parties to the tax agreements was computed, in accordance with such agreements, as the difference between the basic per diem rate and the Mexican per diem rate. In the case of railroads not parties to the agreements, the tax was 10 percent of the gross rental.

50. In the absence of any tax agreements, specific provisions of the Mexican income tax statute provided for the withholding of 10 percent of the gross rentals. In such instances, while the rental income would also be taxed under Schedule I of the Mexican income tax law, deductions would be permitted (such as salaries, overhead, depreciation, and professional services).

51. The Mexican railroads which were not parties to the tax agreements were obligated to pay the amount of the tax withheld from the gross rentals earned, directly to the Mexican treasury department.

52. The Mexican income tax law does not provide for a subsidy to the Mexican railroads, but this law does hold those obligated to withhold amounts as tax, liable at all times jointly with the taxpayer for payment of the tax.

53. The tax imposed by the Mexican income tax law upon the per diem freight rentals earned by the plaintiff while its freight cars were in Mexico, and which tax was withheld by the Mexican railroads for the account of the Mexican treasury, is a foreign income tax within the meaning of the United States Internal Revenue Code.

54. In *Missouri Pacific R.R.* v. *United States*, 301 F. Supp. 839 (E.D. Mo. 1967), *aff'd in part, rev'd in part and remanded*, 411 F. 2d 327 (8th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970), the District Court for the Eastern District of Missouri held, on facts materially identical to those in the instant case, that the taxpayer was entitled to a tax credit for taxes withheld by the Mexican railroads and paid to the Mexican Government. On appeal to the Eighth Circuit Court of Appeals, 411 F. 2d 327, 328 (1969), that court held—

> The primary question below was whether the taxes paid to the Republic of Mexico constituted an income tax so as to permit the taxpayer to credit that amount against its United States income tax liability under §§ 901 and 903 of the 1954 Internal Revenue Code, subject to the limitations set forth in § 904 of the Code. The trial court held that the taxes paid to the Republic of Mexico did qualify as income taxes and the government does not appeal this issue.

55. In response to a request for admissions submitted by plaintiff to defendant, defendant admitted as follows:

> * * * if, in fact, a tax was imposed on plaintiff by the Government of Mexico, and if, in fact, a tax was paid by the plaintiff to the Government of Mexico, then for purposes of this litigation such tax may be deemed an income tax, or a tax in lieu of an income tax, within the meaning and contemplation of Sections 901–904 of the Internal Revenue Code of 1954.

56. Plaintiff's net income from Mexico, attributable to per diem charges earned from the rental of plaintiff's freight cars to Mexican railroads in 1955, was determined in accordance with this court's decision in *Missouri-Pacific R.R.* v. *United States*, 183 Ct. Cl. 168, 392 F. 2d 592 (1968). Accordingly, plaintiff is entitled to a credit against its 1955 Federal income taxes of $74,768.97.

CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, together with interest as provided by law, on the claims relating to (1) § 1341 computation, (2)

excess salvage value, (3) donated property depreciation, (4) casualty loss, (5) welded rail, (6) protective work, and (7) Mexican tax credit, and judgment is entered to that effect. The court further concludes that plaintiff's recovery shall be subject to the setoffs raised by defendant with respect to (1) rail salvage value and (2) vacation pay accrual. The amount of recovery will be determined in subsequent proceedings under Rule 131(c).

TABLE OF CONTENTS

	PAGE
Opinion Below	1
Jurisdiction	1
Question Presented	2
Statutes Involved	2
Statement	2
Argument	5
Conclusion	11

CITATIONS

Cases:

Brown Shoe v. *Commissioner,* 339 U.S. 583	4, 5, 7
Detroit Edison v. *Commissioner,* 319 U.S. 98	4, 5, 6
District of Columbia v. *Sweeney,* 310 U.S. 631	9
Edwards v. *Cuba R.R.,* 268 U.S. 628	4, 5
Helvering v. *Lazarus & Co.,* 308 U.S. 252	8
Rice v. *Sioux City Cemetery,* 349 U.S. 70	9

Statutes:

28 U.S.C. 1255(1)	1
Internal Revenue Code of 1939 (26 U.S.C.)—	
Sec. 113(a)(2) and (8)(B)	6
Internal Revenue Code of 1954 (26 U.S.C.)—	
Sec. 362(c)(1)	8, 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

UNITED STATES OF AMERICA,

Petitioner,

vs.

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Claims

---

BRIEF FOR THE CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY IN OPPOSITION

OPINION BELOW.

The Court of Claims opinion in this case is reported at 455 F. 2d 993. (Pet. App. 1a-80a)

JURISDICTION.

The decision of the Court of Claims was issued February 18, 1972. A petition for a writ of certiorari was filed on July 17, 1972. The jurisdiction of this Court rests on 28 U.S.C. 1255(1).

QUESTION PRESENTED.

Whether respondent railroad is entitled to depreciation deductions for certain safety facilities at rail-highway intersections purchased from the proceeds of contributions to the capital of respondent made by Federal and State Governments.

STATUTES INVOLVED.

The pertinent statutory provisions are set forth in the Petition. (pp. 2-4)

STATEMENT.

Prior to June 22, 1954, certain facilities were contributed to respondent railroad by various governmental bodies. Specifically, such facilities consisted of railroad underpasses, overpasses, and railroad-highway crossing protection devices. These facilities were thereafter, up to and including the tax year here involved (1955), property used in respondent railroad's trade or business, and were property of the type which ordinarily would be acquired through capital expenditures, i.e., property with a useful life in respondent's business in excess of the remainder of the year of acquisition, and were of a character normally subject to the allowance for depreciation.

The aggregate cost of the facilities paid out of public funds with respect to which respondent now seeks to take depreciation was $2,146,140.

As indicated in Finding 9 of the Court below, the facilities were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow. Respondent, however, received benefits from the facilities, among others, probably lower accident rates, reduced expenses of operating crossing facilities, and, where permitted, higher train speed limits, all of which permitted respondent to function more efficiently and presumably less expensively. The decision regarding what facilities to build and where to buld them was made after negotiation between the respective States and respondent. Factors considered included the accident statistics of the crossing points and the need for improved motor-vehicle traffic flow. On projects done in the 1930's, there was also considered how many men could be put to work on a project, since the principal goal of the Federal Government in giving financial support was to make work for persons unemployed during the economic depression. Another purpose of Federal financing was to curtail long-standing disputes between the States and railroads concerning the pro rata share each would pay for construction and improvement of such facilities. (Pet. App. 57a)

Finding 8(b) of the Court below indicates that respondent was obligated to maintain and replace all of these safety facilities at its own expense. It is obvious that the life of highways and consequently overpasses and underpasses is of an indefinite duration, as long as they are properly maintained. Therefore, the railroad obligation of maintenance, standing alone, is practically equivalent to replacement.

Respondent initiated this suit in the Court of Claims regarding several issues of alleged overpayment of its 1955 income tax. Included in these claims was the issue regarding the deductibility for depreciation on the safety facilities at issue before this Court. The Trial Commissioner and a majority of the Court of Claims held that respondent was entitled to include in its depreciation basis the entire amounts paid for or reimbursed pursuant to the capital contributions made by the Government to respondent.

The Court of Claims concluded that the rationale of this Court's decisions in *Brown Shoe* v. *Commissioner,* 339 U.S. 583, and *Edwards* v. *Cuba R.R.,* 268 U.S. 628, rather than *Detroit Edison* v. *Commissioner,* 319 U.S. 98, were controlling. (Pet. App. 7a)

Petitioner also had alleged that respondent had agreed in a "terms letter" to exclude this property from its depreciable base. However, as noted in Findings 10(a) and (b) of the court below, plaintiff had conditioned its acceptance of the "terms letter" without objection by the Internal Revenue Service. Respondent's condition to execution of the terms letter provided that "in the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise," respondent would not be precluded "from the benefits of any such changes regardless of the acceptance herein contained." The lower court properly held that this court's decision in *Brown Shoe, supra,* distinguishing the case of *Detroit Edison, supra,* and holding that certain donated property could be added to the depreciable base produced such a change in the conditions of the terms letter and respondent is entitled to the benefits thereof. (Pet. App. 10a) Further, the reference to Mimeograph 58 was not included in the terms letter furnished respondent. (Pet. App. 58a)

ARGUMENT.

The decision below is correct in result.

1. The decision below is not in conflict with decisions of this Court. Nor is there any conflict between this decision of the Court of Claims and any other court.

As recognized by the Court of Claims, the facts of this case are more analogous to the rationale of this Court's decisions in *Brown Shoe Co.* v. *Commissioner, supra,* and *Edwards* v. *Cuba RR., supra,* than this Court's decision in *Detroit Edison* v. *Commissioner, supra,* and the rationale of *Brown Shoe* is controlling in the instant case.

The facts in the *Detroit Edison* case indicated that potential customers were required to make a deposit to defray the cost of the necessary construction of electric transmission lines when the public utility had concluded that the proposed service would be a marginal or loss operation. Detroit Edison Company contended that the deposits were capital contributions by a non-stockholder invested in a depreciable capital asset owned by the taxpayer, and, as such, subject to depreciation deductions. The government contended that the public utility had no investment in that portion of the assets constructed with the deposit funds and, thus, had no depreciable tax basis with respect thereto.

The key to this court's decision in the *Detroit Edison* case is found in the following language at pages 102 and 103 of the opinion:

> 'The customer payments so far as in question found their way into the Company's capital accounts

by way of an addition to surplus. Their interdependency with the increases in property accounts caused by the construction they induced justified the Commissioner in relating the one to the other for the purpose of adjusting the basis for depreciation.

"The Company, however, seeks to avoid this result by the contention that what it has obtained are gifts to it or contributions to its capital of the property paid for by the customer, and that therefore by the provisions of Sec. 113(a)(2) and (8)(B) it takes the basis of the donor or transferor. It is enough to say that it overtaxes the imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. The transaction neither in form nor in substance bore such a semblance.

"The payments were to the customer the price of the service. The receipts have gone, so far as here involved, to add to the Company's surplus." (emphasis added).

The crucial fact in the *Detroit Edison* case was the unassailed assumption that the deposits were made to obtain goods, services or privileges and not to increase the capital of the corporation.

Seven years later, in 1950, this court issued its decision in the *Brown Shoe* case. In *Brown Shoe,* the company had been allowed depreciation deductions on capital assets acquired in part through the use of funds donated by various communities desirous of inducing such industry to locate in their community. Subsequent to this Court's decision in the *Detroit Edison* case the Commissioner of Internal Revenue commenced to disallow depreciation with respect to that portion of the investment in such assets represented by the contributions made by these political subdivisions.

In the *Brown Shoe* case the government relied upon its view of the scope of this court's decision in the *Detroit Edison* case. It asserted that only the taxpayer's investment could be depreciated for tax purposes.

This court conclusively defined the law in this area and narrowly restricted the scope of the *Detroit Edison* case in the following language found at page 591 of its opinion:

> "* * * We do not consider that case controlling on the issue whether contributions to capital are involved here. Because in the *Detroit Edison* case 'The payments were to the customer the price of the service,' the Court concluded that 'it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company.' Since in this case there are neither customers nor payments for service, we may infer a different purpose in the transactions between petition and the community groups. The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. Under these circumstances the transfers manifested a definite purpose to enlarge the working capital of the company."

Certainly these payments to the respondent at issue in this proceeding were not for any services rendered or to be rendered. Although the primary purpose of the Highway Act was to benefit the public by improving safety and expediting traffic flow it also had a direct effect on railroad operations as found by the court below in its finding No. 9. (Pet. App. 57a). Indeed, but for the capital limitations of railroads they would eliminate

all highway grade crossings in order to achieve a more economic and efficient operation.

Therefore, on balance, the expenditures at issue did prove advantageous to the community at large as well as enlarging the working capital of this respondent. This, of course, is the precise standard applied by this court in *Brown Shoe* permitting depreciation of such contributions to capital.

Although petitioner on page 14 of its petition asserts that respondent had no right to depreciate assets contributed by the government, such theory was obviously rejected by this court in the *Brown Shoe* case. Further, the case of *Helvering* v. *Lazarus & Co.*, 308 U.S. 252, cited by petitioner, specifically holds that depreciation deductions go to the party which "bears the burden of wear and exhaustion of business property", irrespective of who may have legal title or who originally furnished the consideration.

2. Although petitioner asserts that the decision below has great significance in regard to interpretation of the tax laws and that it would have a severe adverse impact on the revenues, such assertions are negated by an analysis of the facts involved.

In fact, this case has very isolated significance since Section 362(c)(1) of the Internal Revenue Code of 1954 provides a zero basis for property acquired by a corporation, on or after June 22, 1954, by means of a contribution to capital. Thus, for over eighteen years the Internal Revenue Code has codified the rule sought by the petitioner, but, by its own terms the statute is made inapplicable to the property at issue in this case, which was acquired prior to June 22, 1954.

As stated in the Committee Reports, the purpose of Section 362(c) was to provide rules:

> "respecting situations similar to that which occurred in *Brown Shoe Company* v. *Commissioner* (39 U.S. 583, 70 S. Ct. 820), a striking recognition of the unequivocal result of the application of such case, Paragraph (1) of subsection (c) provides that in such a case, if property, other than money, is acquired by a corporation after June 22, 1954, as a contribution to capital and is not contributed by a shareholder as such, then the basis of such property to the corporation shall be zero." (Senate Report No. 1622, 83rd Congress, 2nd Session, 1954 U.S. Code, Cong. and Admn. News, p. 4910.)

Rule 19 of this Court requires "special and important reasons" as the basis for this Court's exercise of its discretionary power of review upon a writ of certiorari. This Court has recognized that "special and important reasons" imply a reach to a problem beyond the academic or episodic. Specifically, under analogous circumstances where a statute has made an issue moot or academic, the Court has consistently denied a writ of certiorari. *Rice* v. *Sioux City Cemetery,* 349 U.S. 70. In the *Rice* case the Court stated:

> "Had the statute been properly brought to our attention, and the case thereby put into proper focus, the case would have assumed such an isolated significance that it would hardly have been brought here in the first instance."[*] (at pp. 76-77)

---

[*] Cf. *District of Columbia* v. *Sweeney,* 310 U.S. 631, where certiorari was denied "in view of the fact that the tax is levied under a statute which has been repealed and the question is therefore not of public importance."

To support their position that "substantial revenues" are at issue petitioner can only refer to an "unpublished" statistical report and speculative assumptions by the Internal Revenue Service as to what percent of similar property might still be subject to litigation as to depreciability for future years. Indeed, petitioner concedes that many companies have never segregated similar governmental grants in their accounts. To make such a reconstruction some eighteen years after the fact would obviously be a practical impossibility.

In reference to petitioner's exaggerated estimate of the cost basis of property which might be involved in this issue, it should be noted that respondent has involved in this self-limiting issue a total depreciable base of only $2.1 million.

Therefore, respondent asserts that it would be a needless academic exercise to review the issue in this proceeding when Congressional action has effectively mooted the issue for over eighteen years.

3. Petitioner concedes that there is no present conflict of circuits in regard to this issue and speculates that none will ever arise. Respondent submits that petitioner is requesting this Court to exercise its discretionary power in regard to an isolated matter not involving a conflict between any of the subordinate courts.

4. Even petitioner concedes that the issue relating to the effect of the terms letter agreement between respondent and the Internal Revenue Service is not sufficient in and of itself to justify a petition for writ of certiorari. Only if the Court would decide to resolve the substantive depreciation issue does petitioner request review of the holding of the Court below in regard to the terms letter agreement.

CONCLUSION.

The petition for writ of certiorari should be denied.

Respectfully submitted,

ROBERT T. MOLLOY
1911 N. Fort Myer Drive
Arlington, Virginia 22209

Attorney for
Chicago, Burlington & Quincy
Railroad Company

ROBERT E. SIMPSON
RICHARD T. CUBBAGE
RICHARD J. SCHREIBER
547 W. Jackson Boulevard
Chicago, Illinois 60606
Of Counsel

August 11, 1972

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Summary of argument	9
Argument:	
I. Respondent is not entitled to depreciation deductions with respect to the facilities at issue here, because the governmental agencies which paid for these facilities did not have the requisite intent to enlarge respondent's capital; consequently, the facilities are not depreciable contributions to capital under the Internal Revenue Code of 1939	14
A. The provision of the Internal Revenue Code of 1939 which allowed corporations to depreciate assets donated to them as contributions to capital should be narrowly construed	14
B. The highway-railroad facilities donated to respondent by the governmental agencies are not depreciable contributions to capital because, under the standards established by this Court, they were not donated with the intention of enlarging respondent's capital	18

491-625—72——1

Argument—Continued

Page

II. The terms letter which respondent entered into in order to change its accounting method barred respondent from taking depreciation on the donated highway-railroad facilities ---------------- 26

Conclusion ---------------- 33

Appendix ---------------- 34

CITATIONS

Cases:

Brown Shoe Co. v. *Commissioner*, 339 U.S. 583 ---------------- 8, 11, 12, 13, 20, 21, 22, 30, 31, 32

Chicago, Milwaukee, St. Paul & Pacific R. Co. v. *United States*, 404 F. 2d 960 ---------------- 27, 29

Commissioner v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225 ---------------- 19

Denver & Rio Grande Western Railroad Co. v. *Commissioner*, 32 T.C. 43, affirmed, 279 F. 2d 367 ---------------- 19, 29

Denver & Salt Lake Railway Co. v. *Commissioner*, 24 T.C. 709 ---------------- 29

Detroit Edison Co. v. *Commissioner*, 319 U.S. 98 ---------------- 8, 11, 12, 13, 14, 18, 19, 20, 21, 22, 30

Edwards v. *Cuba Railroad*, 268 U.S. 628 ---------------- 10, 16

Federated Dept. Stores v. *Commissioner*, 426 F. 2d 417 ---------------- 21

Fribourg Nav. Co. v. *Commissioner*, 383 U.S. 272 ---------------- 14

Helvering v. *Lazarus & Co.*, 308 U.S. 252 ---------------- 14, 25

John B. White, Inc. v. *Commissioner*, 55 T.C. 729, affirmed, 458 F. 2d 989, certiorari denied, October 10, 1972 ---------------- 19

Massey Motors, Inc. v. *United States*, 364 U.S. 92 ---------------- 9, 14, 15

Nashville, C. & St. L. Ry. v. *Walters*, 294 U.S. 405 ---------------- 23

Cases—Continued

Page

Reisinger v. *Commissioner*, 144 F. 2d 475 24
United States v. *Ludey*, 274 U.S. 295 14
United States v. *Milnor Corp.*, 85 F. Supp. 931 15
Weiss v. *Wiener*, 279 U.S. 333 .... 12, 24

Statutes:

Federal-Aid Highway Act of 1944, 58 Stat. 838:
- Sec. 1 .... 4, 24
- Sec. 5 22
- Sec. 5(a) 3, 4, 24
- Sec. 5(b) 4

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed):
- Sec. 23 .... 2, 34
- Sec. 23(l) 14, 34
- Sec. 113 .... 2, 25, 34
- Sec. 113(a) 8, 10, 11, 15, 16, 17, 18, 30, 34
- Sec. 113(b) 35
- Sec. 114 .... 2, 36
- Sec. 114(a) 15, 16

Internal Revenue Code of 1954 (26U.S.C.):
- Sec. 118(a) 17
- Sec. 167 .... 2, 36
- Sec. 167(a) 14, 36
- Sec. 167(f) 15, 36
- Sec. 362(a) 17
- Sec. 362(c) 10, 17
- Sec. 446(e) 26
- Sec. 1011 .... 2, 15, 37
- Sec. 1012 .... 2, 15, 37
- Sec. 1052(c) 17

Statutes—Continued

	Page
National Industrial Recovery Act, 48 Stat. 203 (1933), Sec. 204(a)	3, 4
Technical Amendments Act of 1958, P.L. No. 85–866, 72 Stat. 1669, Sec. 94 (known as the Retirement Straight Line Adjustment Act of 1958)	7, 14, 29, 31, 32

Miscellaneous:

S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 107–108	26
Treasury Regulations 111, § 29.41–2	26
Treasury Regulations 118, § 39.41–2	26

In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-90

UNITED STATES OF AMERICA, PETITIONER

v.

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (Pet. 1a–80a) [1] is reported at 455 F. 2d 993.

JURISDICTION

The decision of the Court of Claims was entered on February 18, 1972 (Pet. 1a), but the final judgment has not yet been computed.[2] By order of Chief Justice Burger, the time for filing a petition for a writ of certiorari was extended until July 17, 1972. The petition was filed on July 17, 1972, and certiorari

---

[1] "Pet." references are to the petition for a writ of certiorari.

[2] The court held that respondent was entitled to the refund which it sought, but deferred the computation of the amount pending subsequent proceedings pursuant to its rules. (Pet. 80a.)

was granted on October 24, 1972. (App. 113.)[3] The jurisdiction of this Court rests on 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether, in the computation of its taxable income, respondent railroad was entitled to deduct allowances for depreciation with respect to the costs of certain facilities constructed at highway-railroad intersections, which were paid for not by respondent but out of public funds appropriated for the development of highway systems.

STATUTES INVOLVED

The pertinent provisions of Sections 23, 113 and 114 of the Internal Revenue Code of 1939, and of Sections 167, 1011 and 1012 of the Internal Revenue Code of 1954, are set forth in the Appendix, *infra*, pp. 34–37.

STATEMENT

1. Respondent, an Illinois corporation, is a common carrier by rail in interstate commerce. (Pet. 53a.) Beginning in the early 1930's, various state governments entered into agreements with respondent (as with other railroads) for construction of highway overpasses, underpasses, grade-crossing protection equipment (such as flashing-light signals and automatic gates) and other facilities at highway-railroad intersections. Essentially, respondent agreed to perform that part of the construction work most directly related to railroad use, such as bridges and track

[3] "App." references are to the separately bound record appendix.

signal lights, and the states agreed to perform the work most directly related to highway use, such as roads and approaches for motor vehicles. The agreements also provided that the states would pay from 50 percent to 100 percent of the total cost of the work, including the work performed by respondent. (Pet. 56a.)

After the initial agreements were reached between the states and the railroads, Congress passed a series of acts authorizing the federal government to pay the states' share of the construction costs of facilities at highway-railroad intersections. (Pet. 56a.) Section 204(a) of the National Industrial Recovery Act, 48 Stat. 195, 203 (1933), provided that the government would reimburse the states for—

> all or any part of the cost of * * * the elimination of hazards to highway traffic, such as the separation of grades at crossing, the reconstruction of existing railroad grade crossing structures, the relocation of highways to eliminate railroad crossings, * * * the construction of facilities to improve accessibility and the free flow of traffic, and the cost of any other construction that will provide safer traffic facilities or definitely eliminate existing hazards to pedestrian or vehicular traffic. * * *

In the ensuing years, frequent disputes arose between the governmental bodies and the railroads over the railroads' unwillingness to share in the construction costs of highway-railroad facilities. In order to settle these disputes, Congress passed the Federal-Aid Highway Act of 1944, 58 Stat. 838, Sec. 5 (a) and

(b), which authorized the federal government to reimburse the states for the entire cost of highway-railroad crossing projects (other than rights-of-way), subject only to the limitation that if the railroad received benefits from a constructed facility, it should reimburse the government on a pro rata basis. In no event could the railroad's benefit be deemed more than 10 percent of the cost of the project. (Pet. 47a–48a, 56a–57a.)

Most of the agreements between respondent and the contracting states do not indicate whether respondent or the state has title to the facilities. Under the agreements, however, respondent is required to maintain the facilities "directly related to railroad use," such as bridges, roadbeds and tracks, while the state is required to maintain the facilities "directly related to motor vehicle use," such as highways and approaches. (Pet. 56a.) Although the court below found (Pet. 56a) that respondent was obligated under all of its agreements to replace "at its own expense if needed, equipment originally furnished", the majority of the agreements, as Judge Davis noted in his dissent (Pet. 48a), are silent in this respect. In any event, the majority opinion of the court below did not suggest that the agreements obligate respondents to replace certain types of facilities, such as highway overpasses or underpasses.[4]

[4] Moreover, Section 204(a)(1) of the National Industrial Recovery Act, *supra*, and Sections 1 and 5(a) of the Federal-Aid Highway Act of 1944, *supra*, specifically authorize federal payment for reconstruction of railroad grade crossing structures.

As the Court below found (Pet. 57a), the facilities at issue were constructed "primarily for the benefit of the public, to improve safety and to expedite highway traffic flow."[5] In determining what facilities to build and where to build them, the factors considered by the parties included "the accident statistics of the crossing points and the need for improved motor-vehicle traffic flow." Respondent and the states also considered how many men could be employed on a project, since one goal of the federal government was to create work for persons unemployed during the depression. (Pet. 57a.) The agreements gave no consideration, in allocating funds, to the financial condition or need for capital of respondent and the other railroads. (Pet. 56a.)

The aggregate cost of the publicly funded highway-railroad facilities with respect to which respondent now seeks to take depreciation was $2,146,140, of which $1,538,543, or 71 percent, represented highway undercrossings or overcrossings; $548,877, or 26 percent, crossing signals, signs and floodlights; and $58,721 jetties and bridges. (Pet. 55a.)

2. On February 5, 1943, respondent requested permission of the Internal Revenue Service to change from retirement to depreciation accounting for road property. (Pet. 57a.) On April 12, 1943, the Service responded by letter (App. 56), enclosing Mimeo 58, entitled "Change from Retirement to Depreciation

[5] Respondent did, however, receive some benefit from the facilities, including probable lower accident rates, reduced expenses of operating crossing facilities, and, where permitted, higher train speed limits. (Pet. 57a.)

491-625—72——2

Accounting for Road Property" (App. 57–66). Mimeo 58 was prepared by the Service for circulation to the railroads generally, many of whom were seeking to change from retirement to depreciation accounting during World War II. Setting out guidelines under which the changeover would be acceptable to the Service (Pet. 58a), Mimeo 58 provided in part that (Pet. 8a–9a):

> The basis for depreciation shall be *the cost of the existing depreciable property to the present taxpayer,* determined in accordance with sections 113 and 114(a) of the Internal Revenue Code. * * *
>
> * * * * *
>
> The basis may include only the investment in property which is actually depreciable. * * * *Donated property or contributions or grants in aid of construction from any source must be excluded.* [Emphasis added.]

Mimeo 58 also required that a railroad seeking to make the change in accounting methods furnish the Service with a list of the properties with respect to which it intended to take depreciation, together with their cost basis, salvage value, expired life, and estimated normal useful life. When respondent thereafter furnished the information required by Mimeo 58, it did not include the highway-railroad facilities paid for out of public funds. (Pet. 58a.)

On September 20, 1944, the Service sent respondent a terms letter (App. 52–54), which incorporated the information supplied by respondent with respect to

the property it intended to depreciate and which referred to some of the requirements set out in Mimeo 58. The letter, which did not refer expressly to the treatment of donated property, granted respondent permission "to change from retirement to depreciation accounting as of January 1, 1943," to be effective "upon receipt of a letter agreeing to all the terms and conditions set forth herein." On April 20, 1945 (App. 55), respondent accepted the terms letter with the proviso that its acceptance should not bar it from the benefit of any change in the conditions of the terms letter brought about "by statutory amendment, by operation of law, or otherwise" (Pet. 58a).

On May 1, 1961, respondent requested that the Service permit it to take advantage of the benefit of Section 94 of the Technical Amendments Act of 1958 (known as the Retirement-Straight Line Adjustment Act of 1958), P.L. No. 85-866, 72 Stat. 1669. (See, *infra*, p. 29, n. 14.) Respondent attached to this request revised schedules of its depreciable roadway properties, which again omitted the highway-railroad facilities paid for out of public funds. Responding to this request by letter of July 26, 1961 (App. 68-70), the Service referred to the earlier terms letter and stated that respondent's revised schedules were acceptable effective January 1, 1956, provided respondent had made a timely election as required by Section 94. Respondent had made the necessary election on December 14, 1959. (Pet. 58a-59a.)

3. Respondent brought suit in the Court of Claims alleging that it overpaid its 1955 income tax when

it failed to take deductions for depreciation with respect to the cost of the facilities paid for out of public funds. The Court of Claims held, with three judges dissenting, that respondent was entitled to include in its depreciation base the entire $2,146,140 paid for or reimbursed out of public funds and to take deductions therefor. The majority, relying on *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583, reasoned that even though the governmental payments were not intended to be contributions to respondent's capital but, rather, were intended to absorb part of the cost of building public highway systems, the facilities involved did, in fact, enlarge respondent's working capital and produce economic benefits for respondent; therefore the facilities were depreciable under Section 113(a)(8)(B) of the Internal Revenue Code of 1939, Appendix, *infra,* pp. 34–35, which prescribed a carryover of the transferor's basis for property acquired by a corporation as a contribution to its capital.

Judge Davis, writing for the three dissenting judges, noted that under the test set forth in *Brown Shoe,* and in *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98, there is no contribution to a corporation's capital and, correspondingly, no depreciable basis under Section 113(a)(8)(B), unless property is transferred with a purpose or intent to enlarge the transferee's capital. Here, the dissent reasoned, the states and the federal government paid for the facilities involved not in order to confer a benefit on respondent, but solely in order to expedite the flow of traffic and improve

public safety at highway-railroad crossings. (Pet. 46a-49a.)

The dissent also took the view that respondent had agreed in the 1944 terms letter to exclude the donated property from its depreciation base as one of the conditions to the Service's consent to respondent's change from retirement to depreciation accounting, and that this agreement was binding. (Pet. 49a.) The majority held that respondent had not made a binding agreement to exclude the donated property from its depreciation base. (Pet. 8a-10a.)

SUMMARY OF ARGUMENT

I. Respondent is not entitled under the 1939 Code to depreciation deductions with respect to the facilities at issue here.

A. Under both the 1939 and 1954 Internal Revenue Codes, taxpayers are allowed to take a reasonable depreciation deduction designed to reflect that portion of the taxpayer's investment in certain capital assets which is used up each year through wear and tear and obsolescence. To that end, the basis on which depreciation is allowed with respect to property under both the 1939 and 1954 Codes is generally the cost of that property to the taxpayer. If a taxpayer has made no investment in an asset, so that its gradual consumption represents no actual expense to him, the reason for allowing depreciation does not apply. See *Massey Motors, Inc.* v. *United States,* 364 U.S. 92, 96.

The Internal Revenue Code of 1939, however, which governs the issue before the Court in this case, pro-

vided a limited exception to the general rule that a taxpayer can only depreciate its cost basis in an asset. Section 113(a)(8)(B) of that Code, Appendix, *infra*, pp. 34–35, allowed corporate taxpayers to take depreciation on property acquired after 1920, either from shareholders or nonshareholders, as a "contribution to capital." This provision produced an anomalous result, in that it allowed taxpayers to take depreciation deductions with respect to assets in which they not only had no investment, but which, under this Court's decision in *Edwards* v. *Cuba Railroad*, 268 U.S. 628, they had received free of income tax liability.

Congress recognized the inconsistency inherent in the allowance of depreciation in these circumstances when it enacted Section 362(c) of the Internal Revenue Code of 1954, which provides that assets donated by nonshareholders as contributions to capital have a zero basis in the hands of the transferee. Nonetheless, in cases such as this one which are governed by the 1939 Code, it is necessary to determine whether the donated assets are contributions to the taxpayer's capital, in which case they are depreciable. In retrospect it seems clear that the inquiry whether the transfers were technically contributions to capital ought not to have determined the depreciability of the assets. Though respondent, of course, would be entitled to a depreciation deduction if it were afforded to it by the terms of the 1939 Code, it is reasonable to conclude, in view of the inconsistency between the allowance of depreciation for assets donated by nonshareholders

and the fundamental concept of depreciation as a means of recovering costs actually incurred, that Congress intended that this exceptional provision of the 1939 Code would apply only in a narrow range of circumstances. Indeed, the decisions of this Court establish a rigorous standard which taxpayers must meet in order to depreciate donated assets, a standard not met by the donated properties at issue here.

B. This Court has twice considered whether assets transferred to a corporation by nonshareholders represented "contributions to capital" as that term is used in Section 113(a)(8)(B) of the 1939 Code. In *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98, the Court denied a depreciation allowance to a taxpayer utility company which sought to depreciate electric power lines which its customers had been required to pay for in order to receive the company's services. In *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583, the Court allowed taxpayer to depreciate factory buildings and equipment donated by community citizen groups in order to induce taxpayer to locate or expand its operations in that community. In both these cases the Court tested the assets in question in terms of whether the transferor had a donative intent to increase, or "contribute" to, the capital of the transferee corporation.

In this case, the governmental agencies which contributed the highway-railroad facilities at issue clearly did not intend to "enlarge the working capital" (*Brown Shoe,* 339 U.S. at 591) of the respondent railroad. As the Court of Claims found, "The facili-

ties * * * were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow" (Pet. 57a), and no consideration was given to respondent's need for capital (Pet. 56a). Nor, as Judge Davis noted in his dissent (Pet. 47a), were the facilities of more than marginal benefit or relevance to respondent's railroad business.

The argument of the majority below that respondent is entitled to depreciate these facilities because it is obligated to maintain and replace them at its own expense is not supported by the record. In any event, even if respondent were obligated to maintain and replace these facilities, this would not in itself entitle respondent to take depreciation with respect to these assets. Depreciation is a deduction taken for the exhaustion of an existing investment; there is no depreciation allowance for a future investment. *Weiss v. Wiener,* 279 U.S. 333. Of course, if respondent incurs maintenance and repair costs with respect to these facilities in the future, it can deduct these expenses as they occur. If respondent replaces facilities as they become worn out, it can include the assets which it pays for in its depreciable base at that time.

II. Even if, contrary to our contention, respondent's claim is consistent with the standard set forth by this Court in *Detroit Edison* and *Brown Shoe,* the terms letter which respondent entered into in order to change its accounting method from retirement to straight-line barred respondent from taking depreciation on the donated highway-railroad facilities. In the terms letter, respondent "irrevocably" agreed to ex-

clude "[d]onated property or contributions or grants in aid of construction from any source." (Pet. 58a.) The courts which have considered the effects of these terms letters have generally held or assumed that they are binding.

In support of its conclusion that respondent was not obligated by the terms letter to exclude donated property from its depreciable base, the majority below placed considerable emphasis (Pet. 10a) on the fact that respondent had accepted the terms letter with the provision that its acceptance would not bar respondent from taking advantage of the benefit of any change in the conditions of the terms letter brought about "by statutory amendment, by operation of law, or otherwise." In the majority's view, this Court's decision in *Brown Shoe* brought about a change in the conditions of the terms letter because under that decision respondent would be allowed to take depreciation with respect to the donated assets at issue in this case. *Brown Shoe,* however, does not embody the kind of change in the law that would release respondent from the obligations agreed to in the terms letter, for *Brown Shoe* did not change or purport to change the applicable standard of depreciability which the Court had earlier used in *Detroit Edison.* Respondent itself appears to have recognized this. Indeed, for more than ten years after *Brown Shoe* was decided, respondent continued to exclude donated property from its depreciable accounts. Furthermore, in May 1961, respondent "irrevocably" accepted the conditions of the terms letter a second time, eleven years after the de-

491-625—72——3

cision in *Brown Shoe,* when it agreed not to include donated assets in its depreciable base as a condition to obtaining the benefits of the Retirement-Straight Line Adjustment Act of 1958, 72 Stat. 1669.

ARGUMENT

I. RESPONDENT IS NOT ENTITLED TO DEPRECIATION DEDUCTIONS WITH RESPECT TO THE FACILITIES AT ISSUE HERE, BECAUSE THE GOVERNMENTAL AGENCIES WHICH PAID FOR THESE FACILITIES DID NOT HAVE THE REQUISITE INTENT TO ENLARGE RESPONDENT'S CAPITAL; CONSEQUENTLY, THE FACILITIES ARE NOT DEPRECIABLE CONTRIBUTIONS TO CAPITAL UNDER THE INTERNAL REVENUE CODE OF 1939

A. THE PROVISION OF THE INTERNAL REVENUE CODE OF 1939 WHICH ALLOWED CORPORATIONS TO DEPRECIATE ASSETS DONATED TO THEM AS CONTRIBUTIONS TO CAPITAL SHOULD BE NARROWLY CONSTRUED

Section 23(1) of the Internal Revenue Code of 1939, Appendix, *infra,* p. 34, and its successor, Section 167(a) of the 1954 Code, Appendix, *infra* p. 36, authorize taxpayers to take a reasonable depreciation deduction for the exhaustion, wear and tear, and obsolescence of property used in a taxpayer's trade or business. The purpose of the depreciation allowance is to allow a taxpayer to deduct from his taxable income the portion of his investment in certain capital assets which may have been used up in earning that income. *United States* v. *Ludey,* 274 U.S. 295, 300–301; *Helvering* v. *Lazarus & Co.,* 308 U.S. 252; *Massey Motors, Inc.* v. *United States,* 364 U.S. 92; *Fribourg Nav. Co.* v. *Commissioner,* 383 U.S. 272. To that end, the basis on which depreciation is allowed with respect to property under both the 1939 and 1954 Codes is

generally the cost of that property to the taxpayer, adjusted to reflect prior depreciation. Section 113(a) and (b)(1)(B) and Section 114(a) of the 1939 Code, Appendix, *infra*, pp. 34–36; Sections 167(f), 1011 and 1012 of the 1954 Code, Appendix, *infra*, pp. 36–37. By defining a taxpayer's depreciable basis in terms of cost, Congress manifested its intention that the depreciation deduction should reflect approximately the portion of a taxpayer's expense incurred in the purchase of an asset which is attributable to the production of income in any particular year. As described by a House Report on the 1954 Code, quoted by this Court in *Massey Motors, supra*, 364 U.S. at 102–103:

> "Depreciation allowances are the method by which the capital invested in an asset is recovered taxfree over the years it is used in a business. The annual deduction is computed by spreading the cost of the property over its estimated useful life." H.R. Rep. No. 1337, 83d Cong., 2d Sess. 22.[6]

It follows that, if a taxpayer has made no investment in an asset, so that its gradual consumption represents no actual expense to him, the reason for allowing depreciation does not apply, any more than the rationale for a business expense would apply to a taxpayer who has incurred no expenses. As this Court said in *Massey Motors*, 364 U.S. at 101, "Congress intended by the depreciation allowance not to make

[6] It may be said that "the depreciation allowance is nothing more than the deduction of an estimated *expense incurred by a taxpayer* and reflects the consumption of the capital assets earning the income." *United States* v. *Milnor Corp.*, 85 F. Supp. 931, 938 (E.D. Pa.).

taxpayers a profit thereby, but merely to protect them from a loss."

The Internal Revenue Code of 1939, however, which governs the issue before the Court in this case (see *infra,* p. 17), provided a limited exception to the general rule that a taxpayer can only depreciate its cost basis in an asset. Section 113(a)(8)(B) of that Code, Appendix, *infra,* pp. 34–35, allowed corporate taxpayers to take depreciation on property acquired after 1920, either from shareholders or nonshareholders, as a "contribution to capital." The depreciable basis of property acquired in this manner is the basis of the property in the hands of the transferor, which, in the case of the new assets at issue here, is the transferor's cost. Sections 113(a)(8)(B) and 114(a).

The 1939 Code's allowance of depreciation with respect to assets transferred as contributions to capital, for which the transferee corporation has incurred no cost or expense, produced an anomolous result, especially when it was placed along side this Court's holding in *Edwards* v. *Cuba Railroad,* 268 U.S. 628. In *Cuba Railroad,* the Court held that subsidies given by the Cuban government to promote the construction of railroads in Cuba "were not profits or gains from the use or operation of the railroad," and, consequently, did not constitute income to the transferee corporation. 268 U.S. at 633. The net effect of Section 113 (a)(8)(B) of the 1939 Code and the holding in *Cuba Railroad* was that corporate taxpayers who received donated assets which could be categorized as "contributions to capital" were able to take depreciation

deductions with respect to assets in which they not only had no investment, but which they had also received free of income tax liability.

Congress recognized the inconsistency inherent in the allowance of depreciation in these circumstances when it enacted the Internal Revenue Code of 1954. Section 362(c) of the 1954 Code provides that contributions to capital made by nonshareholders after June 22, 1954, have a basis of zero in the hands of the transferee; consequently, no depreciation deduction can be taken with respect to these assets.[7] The instant case, of course, which involves assets donated prior to June 22, 1954, is governed by the 1939 Code, which allowed depreciation of assets transferred by nonshareholders if the transfers could be classified as contributions to capital. See Sections 362(a) and 1052 (c) of the 1954 Code. Thus, in order to determine whether donated assets are depreciable under the 1939 Code, the courts are required to determine whether the transfers in qustion are, in fact, "contributions to capital" as that term was used in Section 113(a)(8) (B). See *infra,* pp. 18–26.

In retrospect, it seems clear, as Congress recognized when it enacted Section 362 of the 1954 Code, that the inquiry whether assets donated by nonshareholders represented contributions to capital ought not to have been determinative of the question whether the assets were depreciable. This does not, of course, mean that respondent would not be entitled to the depreciation deduction if it were afforded to it by the terms

[7] Under Section 118(a) of the 1954 Code, contributions to capital are excluded from the gross income of the recipient.

of the 1939 Code, which clearly governs the depreciability of the properties under consideration in this case. But, in view of the conspicuous inconsistency between the allowance of depreciation for assets donated by nonshareholders and the fundamental concept of depreciation as a means of recovering costs actually incurred in a taxpayer's trade or business, reflected in both the 1939 and 1954 Codes, we suggest that it is reasonable to conclude that Congress intended that this exceptional provision of the 1939 Code would apply only in a narrow range of circumstances. Correspondingly, the decisions of this Court which have interpreted the term "contribution to capital" in the context of Section 113(a)(8)(B) of the 1939 Code have established a rigorous standard which taxpayers must meet in order to depreciate donated assets. In our view, the donated properties at issue in this case do not meet that standard.

B. THE HIGHWAY-RAILROAD FACILITIES DONATED TO RESPONDENT BY THE GOVERNMENTAL AGENCIES ARE NOT DEPRECIABLE CONTRIBUTIONS TO CAPITAL BECAUSE, UNDER THE STANDARDS ESTABLISHED BY THIS COURT, THEY WERE NOT DONATED WITH THE INTENTION OF ENLARGING RESPONDENT'S CAPITAL

This Court has twice considered whether assets transferred to a corporation by nonshareholders represented "contributions to capital" as that term is used in Section 113(a)(8)(B) of the 1939 Code. In both cases, the Court tested the assets on which taxpayers claimed depreciation in terms of whether the transferor had a donative intent to increase, or "contribute" to, the capital of the transferee corporation. In *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98,

the taxpayer utility company sought to depreciate electric power lines which its customers had been required to pay for in order to receive the company's services. The Court rejected the contention that taxpayer's customers had contributed these assets to taxpayer's capital. "It * * * overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company * * *. * * * The payments were to the customer the price of the service." 319 U.S. at 102–103. The Court noted that ordinarily a taxpayer's depreciable basis is determined with reference to the cost it has incurred in obtaining its depreciable assets, and that here taxpayer had not even been required, because of the holding in *Cuba Railroad, supra,* to treat the receipt of the power lines as income. The opinion concluded that the taxpayer should not be permitted to "recoup through untaxed depreciation accruals on investments it has refused to make." 319 U.S. at 103.

Detroit Edison has been followed in *Commissioner* v. *Arundel-Brooks Concrete Corp.,* 152 F. 2d 225 (C.A. 4); *Denver & Rio Grande Western Railroad Co.* v. *Commissioner,* 32 T.C. 43, 45–46, affirmed on other grounds, 279 F. 2d 368 (C.A. 10); and *John B. White, Inc.* v. *Commissioner,* 55 T.C. 729, affirmed *per curiam,* 458 F. 2d 989 (C.A. 3), certiorari denied, October 10, 1972. In each of these cases, nonshareholders gratuitously transferred property to the taxpayers which added some incremental value to the taxpayer's working capital, but which was primarily intended to yield direct benefits to the transferors.

In 1950, seven years after the *Detroit Edison* decision, the Court decided *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583. In that case, community citizen groups, in order to induce taxpayer to locate or expand its operations in that community, donated to taxpayer factory buildings and equipment and cash to be used in the construction of manufacturing facilities. The only restriction imposed on the use of these donated assets was that they were to be used in the taxpayer's business at agreed locations for specified minimum periods of time. Emphasizing that the intent of the community groups was to add assets to taxpayer's working capital without imposing requirements or restrictions, the court held that the assets represented contributions to taxpayer's capital. Distinguishing the case from *Detroit Edison,* where the transfers were made with a "different purpose" (339 U.S. at 591), the Court said (*ibid*):

> The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. Under these circumstances the transfers *manifested a definite purpose to enlarge the working capital of the company.* [Emphasis added.][8]

---

[8] In neither *Detroit Edison* nor *Brown Shoe* was there any dispute that the property was exhaustible or that it was used for the economic benefit of the transferee in its business. Nor was there any inference that the taxpayer did not have the burden of maintaining and replacing the property in the future

In this case, the governmental agencies which contributed the highway-railroad facilities at issue clearly did not intend to "enlarge the working capital" of the respondent railroad. Indeed, the Court of Claims specifically found that "The facilities * * * were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow" (Pet. 57a), and that the transferors gave no consideration to respondent's need for capital (Pet. 56a). In holding, despite these findings, that the state and federal governments contributed the facilities at issue here to respondent's capital, the court has rejected the test for a contribution to capital set forth by this Court in *Detroit Edison* and *Brown Shoe.*

Nor did the outlay of public funds for the assets respondent seeks to depreciate here actually result in any significant enlargement of respondent's working capital, as did the expenditures at issue in *Brown Shoe.* The facilities, designed to improve safety and highway traffic flow, were obviously peripheral to respondent's business of operating a common carrier by rail. Indeed, the highway overpasses and underpasses, which constitute 71 percent of the total ex-

(see *infra*, pp. 23–25). The only distinction between the cases was in the purpose of the transferors.

In a recent case decided under the 1954 Code, *Federated Dept. Stores* v. *Commissioner*, 426 F.2d 417 (C.A. 6), a real estate developer made donations to the taxpayer to induce it to locate a store in a shopping center on the developer's land. The court held that the donations were excludable from the taxpayer's income, as contributions to capital under Section 118, because any future benefits to the developer, as distinguished from the community, were speculative and indirect. This decision and its rationale are compatible with *Brown Shoe.*

penditures involved here (Pet. 55a), are used in a manner that is essentially unrelated to respondent's business.[9] To the extent that the facilities were deemed to have benefited respondent, Section 5 of the Federal-Aid Highway Act of 1944, 58 Stat. 838, contemplated that respondent would pay its share of the costs. As both *Detroit Edison* and *Brown Shoe* imply, a benefit of this sort, not fundamentally designed to enhance the railroad's assets, does not turn a public expenditure into a contribution to respondent's corporate capital.

Judge Davis, speaking for the three dissenting judges below, reasoned (Pet. 47a)—

> Congress, which funded all or the lion's share of the "donations" as part of the federal highway program, did not have in mind awarding any substantial gratuities to the railroads or increasing their capital. The intended beneficiaries of the program, ultimate and immediate, were the people at large, the auto-travelling segment of the public, and the trucking industry. * * * The benefits to the railroads were small, indirect, and merely incidental—not, as in *Brown Shoe,* large, direct, intended, and immediate. The highway program was certainly not undertaken in order to give free aid to the railroads. What they may have gained was no more than a minor by-product of the overriding aim of Congress (and the states) to reach very different goals. The physical assets left with the

---

[9] Indeed, it may well be that in expediting the flow of automobile, bus and truck traffic, these facilities stimulated respondent's competition and in this respect were contrary to respondent's interests.

> railroads were not central to their business, as in *Brown Shoe* and *Commissioner* v. *McKay Products Corp.,* 178 F. 2d 639, 643 (C.A. 3, 1949), but were peripheral and tangential. That the railroads were to receive these items was not the prime and significant purpose of the Federal Government or the states, but a casual consequence, as it were, of the highway program which had other ends.[10]

In support of its holding that respondent was entitled to depreciate the facilities in question, the majority of the Court of Claims attached "principal importance" to its conclusion that respondent was obligated under its contracts with the states to maintain the facilities and replace them at its own expense. (Pet. 7a–8a.) The record, however, does not support this conclusion. The agreements between respondent and the states obligated respondent to maintain only the facilities directly related to railroad use, such as bridges, roadbeds and tracks; the states were required to maintain the highway portion of the facilities. (Pet. 56a.) Some of the agreements obligated respondent to

---

[10] That the governmental bodies lacked a donative intent in the construction of these facilities is confirmed by this Court's opinion in *Nashville, C. & St. L. Ry.* v. *Walters*, 294 U.S. 405, 421–424, 427. The issue in that case was whether it was reasonable for a state to impose upon the Railway company 50 percent of the cost of highway overpasses and underpasses at rail crossings constructed as part of the Federal-Aid highway program. The Court held that the Supreme Court of Tennessee erred in failing to give weight to the Railway's evidence that the requirement was unreasonable on the ground that the program was for the benefit of the public at large and particularly drivers of motor vehicles, not for the Railway.

replace "equipment originally furnished", but most of the agreements were silent in this respect. (Pet. 48a, 56a.) The majority below did not suggest that respondent was obligated to replace highway overpasses or underpasses. Even if there were such an obligation, it would have little meaning, for Sections 1 and 5(a) of the Federal-Aid Highway Act of 1944, *supra,* specifically authorized reconstruction of railroad grade crossing structures at federal expense.

But even if respondent were obligated to maintain and replace the facilities at issue in the broad manner suggested by the majority below, this would not in itself entitle respondent to take depreciation with respect to these assets. Depreciation is an allowance for the exhaustion of an existing investment; there is no depreciation allowance for a future investment. As this Court said in *Weiss* v. *Wiener,* 279 U.S. 333, 335-336, where a claimed depreciation deduction was not allowed:

> * * * the loss must be actual and present, not merely contemplated as more or less sure to occur in the future. * * *
>
> * * * it is not enough that [taxpayer] has made a contract that very possibly may not be carried out to replace that capital at some future time.[11]

---

[11] See also *Reisinger* v. *Commissioner,* 144 F.2d 475, 478 (C.A. 2), where the court said:

> Only a taxpayer who has a depreciable interest in property may take the deduction, and that interest must be in existence in the taxable period to enable him to show a then actual diminution in its value. It is not enough that the taxpayer may in the future have to make an investment which will then depreciate in value.

Of course, if respondent incurs maintenance and repair costs with respect to these facilities in the future, it can deduct these expenses as they occur. If respondent replaces facilities as they become worn out, it can include the assets which it pays for in its depreciable base at that time.[12]

Respondent seeks here to take a depreciation deduction with respect to assets in which it has no investment and which it has received free of income tax liability as well as free of cost. To permit the depreciation deduction which respondent seeks would impute to Congress the intent to pay twice for the railroad-highway crossing projects constructed at the site of respondent's railroad—once as a part of the Federal-Aid highway program, and once again, to the extent of approximately 50 percent of the cost of the projects, through deductions from respondent's taxable income. To expand in this manner Section 113's

---

[12] The majority of the court below cites (Pet. 8a) *Helvering v. Lazarus & Co.*, 308 U.S. 252, for the proposition that "depreciation deductions go to the party which 'bears the burden of wear and exhaustion of business property,' irrespective of who may have legal title." The taxpayer in *Lazarus & Co.*, however, had a capital investment in the assets it sought to depreciate and was allowed depreciation precisely for that reason. The taxpayer had transferred the assets to a bank in trust, and then leased them back with an option to purchase. This Court held that (p. 255) "the transaction between the taxpayer and the trustee bank, in written form a transfer of ownership with a lease back, was actually a loan secured by the property involved." The Court held that the taxpayer, though technically a lessee, was using (p. 254) "business property in which it had a depreciable capital investment," and was accordingly entitled to depreciation allowances with respect to that property.

narrow exception to the rule limiting depreciation to taxpayer's cost basis is inconsistent with the entire rationale of the depreciation deduction and is in conflict with the decisions of this Court.

II. THE TERMS LETTER WHICH RESPONDENT ENTERED INTO IN ORDER TO CHANGE ITS ACCOUNTING METHOD BARRED RESPONDENT FROM TAKING DEPRECIATION ON THE DONATED HIGHWAY-RAILROAD FACILITIES

Prior to World War II, respondent and other railroads used the retirement method of computing depreciation on their roadway and various other properties. Under this method, the deduction allowed for depreciation is measured by the cost of the assets retired from service during the year. The war years brought about high income and low retirements and, as a consequence, railroads using the retirement method sought to change to the straight-line depreciation method.[13]

For many years, the consent of the Commissioner has been a prerequisite to any change in the method of accounting which a taxpayer employs in computing his income. Treasury Regulations 111 (1939 Code), Section 29.41-2; Treasury Regulations 118 (1939 Code), Section 39.41-2(c); Section 446(e) of the 1954 Code. The Commissioner was generally willing to con-

[13] "[U]nder the retirement method, the original cost of an asset (less salvage value) is charged off against income at the time of the retirement of the asset from use. * * * Under the straight-line method * * *, the original cost of an asset (less salvage value) is charged against income by means of annual deductions over its useful life." S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 107-108.

sent to the railroads' change to straight line depreciation provided that the railroads entered into agreements, called "terms letters", embodying certain specific restrictions on their depreciation deductions. See *Chicago, Milwaukee, St. Paul & Pacific R. Co.* v. *United States,* 404 F. 2d 960, 969–970 (Ct. Cl.).

On April 12, 1943, the Service wrote in reply to respondent's request for consent to change its depreciation method. (App. 56.) The Service announced in this letter that it was enclosing "a mimeograph which states the terms under which permission will be granted and describes the information that should be furnished." The mimeograph enclosed was Mimeo. 58 (App. 57–66), which had been prepared for general circulation to the railroads (Pet. 58a). Miméo. 58 required that an applicant railroad "irrevocably" agree to include in its basis for depreciation (App. 59) "only the investment in property which is actually depreciable,'" and to exclude "[d]onated property or contributions or grants in aid of construction from any source." Respondent was requested to furnish schedules of property which it proposed to depreciate under the straight-line method.

As stated above (*supra,* p. 6), respondent furnished the information required by Mimeo 58, including proposed schedules of depreciable property, which did not include the highway-railroad facilities paid for out of public funds. (Pet. 58a.) The Service subsequently sent respondent a terms letter dated September 20, 1944 (App. 52–54), which granted the permission respondent sought on the condition that re-

spondent "irrevocably" agree to all the terms and conditions in the letter. The terms letter incorporated with approval the schedules respondent had furnished of the properties it proposed to depreciate, with the proviso (App. 52) that any remaining recovery through depreciation allowances "shall be limited to the cost or other basis less the depreciation so accrued." The terms letter did not expressly reiterate the requirement of Mimeo 58 that donated property should be excluded from respondent's depreciable accounts. As noted, however, respondent had already complied with that requirement by excluding donated property from its proposed schedules of depreciable assets.

Thus respondent irrevocably agreed, as a condition to the Commissioner's consent to changing its accounting method, that donated property would be excluded from its depreciable accounts. The fact that the terms letter did not reiterate the exclusion of donated property required by Mimeo 58—an exclusion reflected in the depreciation accounts submitted by respondent and incorporated in the terms letter—does not remove that exclusion from the scope of the agreement between respondent and the Commissioner. As Judge Davis noted (Pet. 49a):

> Mimeo 58, which explicitly excludes donated property from straight-line depreciation, is entwined with the terms letter and forms an integral part of the mutual understanding for the change-over from retirement accounting.

The courts have generally held or assumed that the terms letters between the Commissioner and the rail-

roads are binding. The Court of Claims, for example, has rejected a contention that the depreciation rates required by the terms letters represented an abuse of the Commissioner's discretion. *Chicago, Milwaukee, St. Paul & Pacific R. Co.* v. *United States, supra.* And in determining the applicability of terms letters to losses on abnormal retirements, the Tax Court has assumed that these agreements were fully binding on the railroads. *Denver & Salt Lake Railway Co.* v. *Commissioner,* 24 T.C. 709; *Denver & Rio Grande Western Railroad Co.* v. *Commissioner,* 32 T.C. 43, affirmed on other grounds, 279 F. 2d 368 (C.A. 10).[14]

In support of its conclusion that respondent was not obligated by the terms letter to exclude donated property from its depreciable base, the majority below placed considerable emphasis (Pet. 10a) on the fact that respondent, in its letter to the Service of April 20, 1945 (App. 55), accepted the terms letter with the proviso that its acceptance would not bar respondent from taking advantage of the benefit of any change in the conditions of the terms letter brought about "by statutory amendment, by operation of law, or other-

---

[14] During the 1950's, a controversy arose between the railroad industry and the Commissioner as to the validity of a requirement in the terms letters that taxpayers set up a 30 percent depreciation reserve. This controversy was resolved by enactment of Section 94 of the Technical Amendments Act of 1958 (known as the Retirement-Straight Line Adjustment Act of 1958), P.L. No. 85-866, 72 Stat. 1669, which modified the 30 percent reserve requirement for railroads electing the benefits of that Act. But that legislation was premised on the binding force of the terms letters, and was enacted by Congress to release the railroads from their agreement, but only to the extent specified in the statute.

wise." In the majority's view, this Court's decision in *Brown Shoe* brought about a change in the conditions of the terms letter because under that decision respondent would be allowed to take depreciation with respect to the donated assets at issue in this case.[15]

Even if, contrary to our contention, the standard applied in *Brown Shoe* does not preclude respondent from depreciating the donated properties at issue here, we submit that the *Brown Shoe* decision does not embody the type of change in the law that would release respondent from the obligations agreed to in the terms letter. To begin with, *Brown Shoe* did not change or purport to change the applicable standard of depreciability which the Court had earlier used in the *Detroit Edison* case. Though these two cases reached different results on substantially different facts, both held that the donative intent of the transferor determines whether assets such as those at issue here represent contributions to capital under Section 113(a)(8)(B). See *supra*, pp. 18–26. Indeed, respondent itself appears to have recognized that *Brown Shoe* did not change the standard of depreciability of

[15] If this Court agrees with our interpretation of *Brown Shoe*, of course, it need not consider the effect of the terms letter, for the majority's holding that *Brown Shoe* changed the conditions of the terms letter is premised upon its view that respondent is entitled under the holding in *Brown Shoe* to depreciate these donated properties. If the Court does not agree with our view that respondent is precluded from taking depreciation with respect to these properties by the standard set forth in *Brown Shoe* and *Detroit Edison*, then our position is that the terms letter barred respondent from including the donated properties in its depreciable base.

donated assets; significantly, for more than ten years after *Brown Shoe* was decided, respondent continued to exclude donated property from its depreciable accounts (see, *infra*, p. 32).

Respondent's reservation of the right to benefit from any changes brought about "by statutory amendment, by operation of law, or otherwise," surely could not operate to free respondent of conditions in the terms letter by reason of judicial decisions which did not constitute a clear departure from prior law, but which merely reflected an evolving interpretation of existing law, as in the case of *Brown Shoe.* If the covenants exacted by the Commissioner as a condition to his allowing taxpayers to change their accounting methods are to have any significance, their bar cannot be limited to claims that are obviously frivolous under the statutory and decisional law; they must also mean at least that taxpayers have agreed not to assert claims that might, if litigated, be held consistent with the rationale of some future judicial decision. Otherwise, respondent's agreement not to include these donated properties in its depreciable base would be meaningless, for it would mean that respondent agreed only to refrain from doing what it would have no arguable legal basis to do.

Furthermore, in May 1961, when respondent requested permission to take advantage of the Retirement Straight Line Adjustment Act of 1958, 72 Stat. 1669, it submitted revised schedules of its depreciable roadway properties which did not include the donated highway

railway facilities. The Service replied to respondent's request by letter of July 26, 1961. (App. 68.) In accordance with Section 94(e) of that Act, which provided that the conditions contained in the terms letters signed in the 1940's would be binding on the railroads electing the benefits of the Act, the Service's letter referred to the original terms letter and stated that respondent's revised depreciation schedules would become effective January 1, 1956, provided that respondent had made a timely Section 94 election. Respondent had made the required election which, under Section 94(e), included acceptance of the earlier terms letter. In a letter dated December 14, 1959 (App. 67), respondent stated that it "irrevocably elects to have Section 94 of the Technical Amendments Act of 1958, also known as the Retirement-Straight Line Adjustment Act of 1958, apply to the determination of its Federal tax liability for all applicable years." In effect, respondent "irrevocably" accepted the terms letter a second time, eleven years after the decision in *Brown Shoe*, and indicated by the omission of donated assets from its revised schedule of depreciable property its continuing understanding that those assets were not to be depreciated.

It is true, as the majority below suggested, that the exclusion of donated property from respondent's depreciable base reflected the Commissioner's "opinion" that these assets were not depreciable. Indeed, it is hardly likely that the terms letter would have contained conditions which the Service did not believe to be consistent with the tax laws. It is difficult to understand, however, on what basis the majority of

the Court of Claims could have concluded that these conditions, which respondent "irrevocably" accepted, were not intended to be binding. The majority's suggestion (Pet. 10a) that it is "reasonable to infer that plaintiff acquiesced in the condition, without agreeing with it, simply to avoid possible refusal of its requested change in accounting methods" is somewhat baffling. The fact is that respondent agreed, in return for authorization of its accounting changes, to abide by the conditions of the terms letter. We know of no principle of contract law which would allow respondent to avail itself of the Commissioner's authorization while avoiding the conditions for that authorization on the basis of an unstated mental reservation not to be bound by respondent's end of the agreement.

CONCLUSION

For the reasons stated, the judgment of the Court of Claims should be reversed.

Respectfully submitted.

Erwin N. Griswold,
Solicitor General.

Fred B. Ugast,
Acting Assistant Attorney General.

Richard B. Stone,
Assistant to the Solicitor General.

Meyer Rothwacks,
Grant W. Wiprud,
Attorneys.

December 1972.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

* * * * *

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor

upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(b) [as amended by Sec. 1, Act of July 14, 1952, c. 741, 66 Stat. 629] *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount—

(i) allowed as deductions in computing net income under this chapter or prior income tax laws, and

(ii) resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under this chapter (other than subchapter E), subchapter E of chapter 2, or prior income, war-profits, or excess-profits tax laws,

but not less than the amount allowable under this chapter or prior income tax laws. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(f) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

* * * * *

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.

SEC. 1012. BASIS OF PROPERTY—COST.

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P. relating to capital gains and losses). * * *

U.S. GOVERNMENT PRINTING OFFICE: 1972

TABLE OF CONTENTS

PAGE

OPINION BELOW 1

JURISDICTION 2

QUESTION PRESENTED 2

STATUTES INVOLVED 2

STATEMENT 3

SUMMARY OF ARGUMENT 9

ARGUMENT 12

I.

Under The 1939 Internal Revenue Code Respondent Is Entitled To Depreciation Deductions On Property Used In Its Trade Or Business Acquired From The Proceeds Of Contributions To Respondent's Capital Made By Governmental Units When It Has The Obligation To Replace Such Property 12

A. Respondent Had The Obligation To Replace The Rail Safety Facilities Contributed By Governmental Units And Is Entitled to Depreciation Deductions 12

B. Section 113 Of The 1939 Internal Revenue Code Provides The Basis For Depreciation Allowances On Respondent's Rail-Highway Safety Facilities Contributed By Non-Shareholders 16

C. Direct Effect And Purpose Of Contributions Made By Governmental Units Was To Increase Respondent's Working Capital 19

D. 1954 Internal Revenue Code Revisions Limited To Apply Prospectively Only From June 22, 1954 24

II.

Terms Letter Agreement Between Respondent And Commissioner Is No Bar To Respondent's Claim For Depreciation Allowances 27

CONCLUSION 32

APPENDIX 1a

CITATIONS

Cases:

Boston & Maine R.R. v. Commissioner, 206 F. 2d 617, 619 (C.A. 1) 31

Brown Shoe Co. v. Commissioner, 339 U.S. 583 .... 9, 13, 16, 19, 23, 28, 29

Chicago, Milwaukee, St. Paul & Pacific R. Co. v. United States, 404 F. 2d 960 (Ct. Cl. 1968) 31

Claridge Apartments v. Commissioner, 323 U.S. 141 .... 11, 26

Commissioner v. McKay Products, 178 F. 2d 639 (C.A. 3) 13, 20

Denver & Salt Lake Railway Co. v. Commissioner, 24 T.C. 709 31

Denver & Rio Grande Western Railroad Co. v. Commissioner, 32 T.C. 43 31
Detroit Edison v. Commissioner, 319 U.S. 98 .. 10, 18, 29
Edwards v. Cuba Railroad, 268 U.S. 628 24
Fitch Co. v. United States, 323 U.S. 582 17
Fribourg Nav. Co. v. Commissioner, 383 U.S. 272 .. .. 13, 14
Helvering v. Lazarus & Co., 308 U.S. 252 13
Massey Motors Inc. v. United States, 364 U.S. 92 .. .. 13, 14
Shakespeare Co. v. United States, 419 F. 2d 839 (Ct. Cl. 1969) Cert. denied 400 U.S. 820 17
Teleservice Co. of Wyo. Val. v. CIR, 254 F. 2d 105, cert. denied 357 U.S. 919 26
United States v. Ludey, 274 U.S. 295 .... 13, 14
United States v. Menasche, 348 U.S. 528 17
United States v. National Association of Real Estate Boards, 339 U.S. 485 15
United States v. Yellow Cab Co., 338 U.S. 338 .... 9, 15
Veterans Foundation v. Commissioner of Internal Rev., 317 F. 2d 456 (C.A. 10) 26
Weiss v. Wiener, 279 U.S. 333 13

Statutes:

Federal Aid Highway Act of 1944, 58 Stat. 838 5
Internal Revenue Code of 1939 (U.S.C. 1952 Ed.):
Secs. 23(1) 12
113 .... 2, 9, 28, 29, 1a
113(a)(2) 9, 16, 17, 18
113(a)(8)(B) 9, 10, 13, 17, 18, 19, 28
114(a) 28

Internal Revenue Code of 1954 (26 U.S.C.):
Secs. 118 .... 2, 24, 2a
167(a) 12
362 .... 2a
362(c) 10, 24, 25
National Industrial Recovery Act, 48 Stat. 195, 203 5
Retirement Straight Line Adjustment Act of 1958, 72 Stat. 1669 30

Miscellaneous:

Federal Rules of Civil Procedure, Rule 52 15
64 Harvard Law Review 149-151 (1950) "The Supreme Court, 1949 Term" 24
House Report, Internal Revenue Code of 1954, 83d Cong., 2d Sess. 25
Interstate Commerce Commission, Uniform Accounting Regulations, 49 Code of Federal Regulations, Part 1200-1210 3
Mertens, "Law of Federal Income Taxation" Volume 3A, Sec. 21.134 26
Senate Report, Internal Revenue Code of 1954, 83d Cong., 2d Sess. 24-25
Treasury Regulations, 118 Sec. 39.113(a)8-1 17

In The

Supreme Court of the United States

October Term, 1972

UNITED STATES OF AMERICA,

Petitioner,

vs.

CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY,

Respondent.

On Writ Of Certiorari To The United States Court Of Claims

BRIEF FOR THE CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY

OPINION BELOW.

The opinion of the Court of Claims (Pet. 1a-80a)[1] is reported at 455 F. 2d 993.

---

[1] "Pet." references are to the petition for a writ of certiorari.

JURISDICTION.

The petition was filed on July 17, 1972, and certiorari was granted on October 24, 1972. (App. 113.)[2] The jurisdiction of this court rests on 28 U.S.C. 1255(1).

QUESTION PRESENTED.

Whether, in the computation of its depreciation allowances, respondent railroad was entitled to include property acquired by it prior to June 22, 1954 from the proceeds of transfers or contributions to its capital from governmental units under circumstances where respondent bears the risk of economic loss and has the obligation to replace such property.

STATUTES INVOLVED.

In addition to the statutory provisions set forth in the appendix to petitioner's brief, respondent has set forth in this appendix Sec. 113(a)(2) of the Internal Revenue Code of 1939, and the pertinent provisions of Secs. 118 and 362 of the Internal Revenue Code of 1954.

---

[2] "App." references are to the separately bound record appendix.

STATEMENT.

This case involves the proper tax treatment of the cost of certain railroad property. Contrary to suggestions in petitioner's statement, this case is not concerned with the cost of highway overpass structures, or highway grading or paving. The only items which respondent claims depreciation on are portions of the cost of railroad bridge structures over highways and of crossing protection signals and automatic gates at highway-rail intersections.

The Interstate Commerce Commission prescribes uniform accounting regulations designed to show the cost of property owned by rail carriers. These are specified in several primary accounts.[3] Respondent claims a depreciation basis of $1,528,403.54 for rail bridges in Account 6 (App. 51). Respondent also claims a depreciation basis of $548,876.82 for signal protection in Account 27. This is 97% of the total amount claimed. Account 6 of the Interstate Commerce Commission Uniform Accounting Regulations provides:

> "This account shall include the cost of the substructure and superstructure of bridges, trestles and culverts which carry the tracks of the carrier over watercourses, ravines, *public* and private highways, and other railways." (49 Code of Federal Regulations, Part 1201.)

In Account 6, there is no provision for inclusion of any highway structures since it is limited to rail bridges which carry respondent's tracks over public highways.

---

[3] Sec. 49 Code of Federal Regulations, Part 1200-1210.

Petitioner's assertion in their statement (Brief p. 5) that 71% of the amount claimed as the total depreciation basis by respondent represented highway overcrossings or undercrossings is inaccurate since that percentage figure relates solely to railroad bridges over public highways as shown above. No claim has ever been made by respondent for a depreciation basis on highway overcrossings or undercrossings.

These railroad facilities were located on respondent's property. They and other similar facilities were installed by respondent between 1924 and 1954. Respondent was reimbursed in part as to some of such projects from proceeds of contributions to its capital made by various governmental units. (App. 35-51, Joint Ex. 5)

The parties agreed that such facilities were property used in respondent's trade or business and were property of the type which ordinarily would be acquired through capital expenditures and were of a character normally subject to an allowance for depreciation. (Pet. 5a)

In many cases, the proposals for installation of the safety facilities originated when local communities petitioned their State Public Service Commission for installation of such facilities at rail-highway intersections (App. 95). In all the states in which respondent operates, the State Public Service Commissions have jurisdiction over (a) whether such facility must be installed by a railroad, and (b) if so, in what ratio the cost must be apportioned. (App. 94) Prior to the time reimbursement from federal highway funds was available, the cost for such installations were assessed against railroads, including respondent, at various ratios up to and sometimes ex-

ceeding 50% of the total. (App. 94) These costs were necessarily paid by respondent out of its working capital. As indicated by petitioner, one of the primary purposes of the National Industrial Recovery Act, 48 Stat. 195, 203 (1933) and the Federal Aid Highway Act of 1944, 58 Stat. 838, was to create funds to reimburse respondent and other railroads for the initial cost of certain rail-highway safety facilities. These transfers to respondent had the net effect of increasing its working capital, as well as accelerating the installation of such safety facilities throughout the country. (App. 80)

The Bureau of Public Roads allocated federal funds among the states for rail safety facilities based on a ratio of highway miles to railroad miles within each state. The State Highway Commissions allocated the funds among railroads within their state based on relative ratios of railroad mileages. (App. 91) Respondent's agreements covering the involved facilities were with the State or local governmental units. Under all such agreements respondent was obligated, at its own expense, to maintain, and replace if needed, the equipment originally installed. Respondent was required to maintain and replace the facilities directly related to railroad use, such as rail bridges and crossing signals, and the State was required to maintain and replace the facilities directly related to motor vehicle use, such as paving and embankments. (Pet. 56a)

The issue in this proceeding is the depreciation allowances on the cost of facilities directly related to railroad use. No facilities directly related to highway use are involved. Respondent claimed depreciation deductions for the year at issue in the amount of $52,789.22. The maxi-

mum amount which would be added to respondent's depreciation basis is $2,146,140. (Stipulation of Facts, pp. 5-6) The precise tax benefit in other years to respondent would vary depending on the effective tax rate and the date of installation of the facility.

The Trial Commissioner and the Court of Claims found that the involved facilities were constructed primarily for the benefit of the public, to improve safety and to expedite highway traffic flow. In addition, respondent received benefits from the facilities, including probable lower accident rates, reduced expenses of operating crossing facilities, and, in certain cases, higher train speed limits. All of this permitted respondent to function more efficiently and presumably less expensively. (Pet. 57a) The record and the findings are that the primary benefit of the transfers or contributions to respondent's capital was the better assurance of the welfare and protection of the public at large. (Pet. 7a)

2. In 1945, petitioner and respondent entered into an agreement commonly referred to as a "terms letter." (Pet. 58a) The purpose of the terms letter was to permit respondent and other railroads to change their method of accounting from retirement-replacement accounting to straight line depreciation accounting for certain rail way property. (App. 52)

Mimeo 58 was a document setting out certain suggested guidelines regarding a changeover in method of accounting, and was enclosed with the Internal Revenue Service's response to respondent's request for change in accounting method. It provided, in part, that:

> "The basis for depreciation shall be the cost of the existing depreciable property to the present taxpay-

er, determined in accordance with Sections 113 and 114(a) of the Internal Revenue Code * * *."

By letter dated April 20, 1945, respondent accepted the terms letter agreement, which did not incorporate by reference the Mimeo 58 suggested guidelines, providing, however, that "In the event that if any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise" respondent would not be precluded "from the benefits of any such changes," and would be "entitled to the benefit of any such changes regardless of the acceptance herein contained." (Pet. 58a, App. 55)

The retirement method of accounting is a method recognized and accepted as proper by the Commissioner of Internal Revenue in the determination of annual depreciation deductions. Respondent continues to employ such method of depreciation accounting in regard to its investment and track accounts. Under this method of depreciation accounting, no annual depreciation deductions are taken on capital assets. Instead, a deduction for the total original cost of the asset is taken upon its ultimate retirement. The total of such deductions within a taxable year represents the depreciation allowances with respect to all items being accounted for under this system for such year. (Pet. 15a-16a)

The terms letter and the Mimeo 58 suggested guidelines related only to which of two proper methods of depreciation accounting should be applied to respondent's assets. The question now presented to this Court is whether respondent is entitled to *any* depreciation allowances for the involved assets.

3. Respondent initiated this suit in the Court of Claims, alleging, among other claims, that it had overpaid its 1955 income tax because it had not accrued depreciation allowances with respect to the cost of rail-highway safety facilities paid for out of transfers or contributions to its capital by governmental units. The Trial Commissioner and the Court of Claims held that respondent was entitled to additional depreciation deductions in 1955 in the amount of \$52,789.22 on its depreciation base of \$2,146,140 paid for or reimbursed by governmental units. This opinion of the Trial Commissioner and the Court of Claims that respondent was entitled to take the basis of the transferor was based on Section 113(a)(8)B of the Internal Revenue Code of 1939 which prescribed a carryover of the transferor's basis for property acquired as a contribution to capital. (Pet. 10a)

Both the Trial Commissioner and the Court of Claims held that respondent had not made a binding agreement to exclude the property from its depreciation base when it executed the terms letter agreement of 1945. (Pet. 10a)

SUMMARY OF ARGUMENT.

I. Under the 1939 Code, a taxpayer is entitled to depreciation deductions for assets if it bears the risk of economic loss and has the obligation of replacement.

A. The general rule under the 1939 Code was that a taxpayer was entitled to depreciation allowances only on its actual investment in physical assets. However, this rule is subject to a number of exceptions. These include the one here involved, that a taxpayer is entitled to carry over the basis of a transferor on a contribution to capital from a nonshareholder, when the taxpayer bears the risk of economic loss and has the obligation to replace the property. *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583 (1950).

The Court of Claims made a specific finding that respondent was obligated to replace those rail safety facilities directly related to rail use. (Pet. 7a-8a) Such a finding of fact based on an analysis of the evidence submitted at trial and reviewed by the Court of Claims must be accepted as decisive of the replacement issue, "unless clearly erroneous." *United States* v. *Yellow Cab Company,* 338 U.S. 338, 341-342 (1949).

B. The statutory basis for the exception to the general rule regarding the availability of depreciation allowances, was Section 113 of the 1939 Internal Revenue Code. Section 113(a)(2) provided for a carryover basis in the hands of the transferee if property was acquired by gift. Section 113(a)(8)(B) provided for an assump-

tion of the transferor's basis if the property was acquired from a shareholder as paid-in surplus, or if it was a nongratuitous transfer or contribution by a nonshareholder.

The *Brown Shoe* decision correctly applied the rule of statutory construction in holding that nongratuitous transfers from nonshareholders were governed by Section 113(a)(8)(B). Donative intent is not required for such transfers under that subsection.

The distinction between the receipts in *Detroit Edison* v. *Commissioner,* 319 U.S. 98 (1943) and the receipts in the *Brown Shoe* case, was a recognition that the transfers from the prospective customers in *Detroit Edison* were the price of the service rather than a nongratuitous contribution to capital.

C. Respondent had a preexisting and continuing obligation to construct rail safety facilities. Therefore, any reimbursement for such costs by nonshareholders results in and indicates an intent and purpose to enlarge respondent's working capital. A comparison of the circumstances in this case with those in the *Brown Shoe* decision demonstrates a similar manifest purpose and intent to provide facilities which would benefit the public at large.

D. The legislative history of Section 362(c) of the 1954 Internal Revenue Code clearly indicates that it was intended to overcome prospectively the effect of the *Brown Shoe* decision. It provides that nongratuitous transfers by nonshareholders shall take a zero basis for purposes of depreciation allowances. This statutory codification of the rule sought by the Commissioner of Internal Revenue in the *Brown Shoe* case cannot be retro-

actively applied to property acquired by respondent prior to the June 22, 1954 effective date. *Claridge Apartments v. Commissioner,* 323 U.S. 141, 164 (1944).

II. The terms letter agreement between respondent and the Commissioner of Internal Revenue, as well as the suggested guidelines contained in Mimeo 58, are clearly qualified as providing that depreciation accounting in accordance with all applicable sections of the Internal Revenue Code will be followed, and, where necessary, proper accounting adjustments shall be made. The Mimeo 58 guidelines were not included in the terms letter agreement. Therefore, the references relied on by petitioner were not a part of the actual agreement between the Commissioner and respondent.

When this Court in the *Brown Shoe* decision authoritatively determined the applicability of Section 113 to nongratuitous transfers by nonshareholders, the conditions of the terms letter agreement were changed and respondent became entitled to the benefits thereof. In addition, the suggested guidelines contained in Mimeo 58, even if applicable, were superseded by judicial determination.

All the cases cited by petitioner are inapposite because they neither considered the effect of a subsequent change in law on a terms letter agreement nor were they based on references in the suggested Mimeo 58 guidelines relied upon by petitioner in this case.

ARGUMENT.

I.

UNDER THE 1939 INTERNAL REVENUE CODE RESPONDENT IS ENTITLED TO DEPRECIATION DEDUCTIONS ON PROPERTY USED IN ITS TRADE OR BUSINESS ACQUIRED FROM THE PROCEEDS OF CONTRIBUTIONS TO RESPONDENT'S CAPITAL MADE BY GOVERNMENTAL UNITS WHEN IT HAS THE OBLIGATION TO REPLACE SUCH PROPERTY.

The railroad facilities involved in this case were used in respondent's business. Respondent had the obligation to replace them when needed; they were, in fact, contributed to it by a nonshareholder; and the result was to increase respondent's working capital. Under these circumstances, respondent had a basis under the 1939 Code equal to their cost. In the following sections each of these elements will be discussed.

A. Respondent Had The Obligation To Replace The Rail Safety Facilities Contributed By Governmental Units And Is Entitled To Depreciation Deductions.

Petitioner and respondent are in agreement that Section 23(1) of the Internal Revenue Code of 1939, as well as its successor, Section 167(a) of the 1954 Code, authorize taxpayers to take a reasonable depreciation deduction for the exhaustion, wear and tear, and obsolescence of property used in a taxpayer's trade or business. Petitioner cites several decisions in support of the general rule that the purpose of a depreciation allowance is to allow a taxpayer to deduct from his taxable income

the portion of his investment in certain capital assets which may have been used up in earning that income.[4]

It is respondent's position that under the 1939 Code there are a number of exceptions to the general rule.[5] One of these exceptions, covering the present case, is based on whether taxpayer bears the risk of economic loss or has the obligation to replace the assets, regardless of who made the investment. *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583.[6] The cases cited by petitioner are in any event clearly distinguishable from the factual situation present in this case. Indeed, the *Lazarus* case logic is more consistent with the *Brown Shoe* exception since it held that even a lessee could claim a depreciation allowance on property if the lessee, in fact, bears the risk of economic loss. 308 U.S. 252, 254.

In the *Weiss* case the taxpayer asserted a claim for depreciation allowances on property leased by him for subletting to other parties. Since the lessee in the *Weiss* case could not show an interest in the property and a present loss to him, the Court rightfully denied the taxpayer's claim for depreciation. However, the *Weiss* case also stands for the proposition that in determining the

---

(4) *United States* v. *Ludey,* 274 U.S. 295, 300-301; *Helvering* v. *Lazarus & Co.,* 308 U.S. 252; *Massey Motors Inc.* v. *United States,* 364 U.S. 92; *Fribourg Nav. Co.* v. *Commissioner,* 383 U.S. 272; *Weiss* v. *Wiener,* 279 U.S. 333.

(5) Section 113(a) had 23 enumerated subsections creating such exceptions, including 113(a)(8)(B). A number of these exceptions were carried forward as part of the 1954 Code.

(6) See also *Commissioner* v. *McKay Products,* 178 F. 2d 639, 643 (C. A. 3, 1949).

availability of depreciation allowances, one must initially determine who bears the risk of economic loss. 279 U.S. 334, 336.

The *Massey Motors* case is wide of the mark since it simply held that for purposes of depreciation allowances the useful life of the asset must be related to the period for which it may reasonably be expected to be employed in taxpayer's business. 364 U.S. 92, 104.

The *Ludey* case simply stands for the principle that the depreciation charge represents the reduction during the year of the capital assets through wear and tear of the plant used. 274 U.S. 295, 300.

In the *Fribourg Navigation* case, the Commissioner disallowed depreciation deductions in the year an asset was sold for a price in excess of its adjusted basis. This Court held that the taxpayer was entitled to year-of-sale depreciation. 383 U.S. 272, 277.

In this case, all indicators are that respondent is to bear the risk of economic loss due to gradual wear or obsolescence. This is clear from the unassailed findings of fact made both by the Trial Commissioner and the Court of Claims. These conclude that respondent has the obligation to replace at its expense, equipment and facilities directly related to rail use. (Pet. 56a) As this Court held in the *Brown Shoe* case, under the 1939 Code the replacement of assets is of primary importance regardless of who made the investment.

Although petitioner cites a portion of the dissenting opinion of the court below regarding the extent of respondent's obligation under the 173 agreements admitted into evidence at the trial (Plaintiff's Exhibits 1-173),

petitioner does not directly attack the Trial Commissioner's and Court of Claims' specific fact finding on this issue. As stated by the Court of Claims:

> "Of principal importance, under every contract for constructing the facilities, plaintiff is obligated to maintain and replace the facilities at its own expense. This obligation places squarely on plaintiff the economic loss attendant to wear and tear of the property." (Pet. 7a-8a)

This finding based on the Court of Claims' analysis of the 173 detailed agreements submitted into evidence must be accepted as decisive of the replacement issue, "unless clearly erroneous." *United States* v. *Yellow Cab Company,* 338 U.S. 338, 341-342 (1949); *United States* v. *National Association of Real Estate Boards,* 339 U.S. 485, 495-496 (1950); Rule 52, Federal Rules of Civil Procedure.

In further support of this finding is the fact that in order to continue its common carrier operations, respondent, even in the absence of a specific contractual obligation of replacement, would be compelled to make needed replacements of vital links in its system, such as rail bridges over highways. It would have no practical alternative.

Petitioner further asserts that this finding is not decisive since it obligated respondent to maintain and replace only the facilities directly related to railroad use, while requiring the states to maintain and replace the highway portion of the facilities. (See discussion at page 23 of petitioner's brief.) However, this contention overlooks the fact that respondent is only claiming depreciation deductions on the facilities directly related to rail

use such as bridges and signals.[7] Respondent has never sought to claim depreciation allowances in regard to the highway portion of the facilities which would substantially exceed the relatively minor cost of the directly related rail facilities.[8]

B. Section 113 Of The 1939 Internal Revenue Code Provides The Basis For Depreciation Allowances On Respondent's Rail-Highway Safety Facilities Contributed By Non-Shareholders.

In the *Brown Shoe* case, 339 U.S. 583, this court had to consider one of a number of statutory exceptions to the general rule that a taxpayer must make an investment before being entitled to a depreciation deduction.

The exceptions were created by Section 113(a) of the 1939 Internal Revenue Code which governs the issue before the court in this case. It provides, in relevant portions:

> "Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—
>
> (2) if the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the transferor. * * *
>
> (8) Property acquired by issuance of stock or as paid-in surplus.—If the property was acquired after December 31, 1920, by a corporation—* * *

---

(7) Throughout its brief, petitioner refers to the facilities involved as "highway-railroad facilities." This carries the misleading suggestion that we are dealing with concrete highway overpass structures, paving, and highway grading, which is not the case. The issues in this case actually involve "railroad facilities" located at certain highway intersections.

(8) See Joint Exhibit 5 (App. 35-51). This lists the various rail bridges and the cost with respect to each.

> (B) As paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor. * * *"

The regulation pertinent to Section 113(a)(8)(B) states:

> "In respect to property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from *any person* as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. * * *" (Treasury Regulations 118, § 39.113 (a) (8)-1)

It is evident from the statute and regulation that contributions to capital may originate with nonshareholders, since, if a contribution is made by a shareholder a corporation would acquire basis under the "paid-in surplus" provision of Section 113(a)(8)(B). If it is a gift from a nonshareholder, the recipient would acquire the donor's basis under Section 113(a)(2). Therefore, unless the "contribution to capital" provision of Section 113(a)(8)(B) contemplated nongratuitous transfers by nonshareholders, it would serve no purpose in the Code, since it is a basic rule of statutory construction to give effect to all provisions.[9] This was the logical rationale of the *Brown Shoe* decision, since the transfers at issue in that case, as here, were neither gifts nor made by shareholders.

---

[9] *United States* v. *Menasche*, 348 U.S. 528. Courts are powerless to rewrite tax statutes. See *Fitch Co.* v. *United States*, 323 U.S. 582 (1945); *Shakespeare Co.* v. *United States*, 419 F. 2d 839 (Ct. Cl., 1969), Cert. denied 400 U.S. 820 (1970).

Prior to the *Brown Shoe* case, this Court had occasion to analyze Section 113(a) of the 1939 Internal Revenue Code in its decision in *Detroit Edison* v. *Commissioner,* 319 U.S. 98. In the *Detroit Edison* case, nonrefundable deposits were made by potential customers in order to obtain utility services which would not otherwise be made available to them. The taxpayer utility asserted that it was entitled to depreciation deductions on investments made with the nonrefundable deposits pursuant to either Section 113(a)(2) or 113(a)(8)(B) of the 1939 Code. However, this Court denied the utility's claim to depreciation deductions, stating:

> "It is enough to say that it overtaxes imagination to regard the farmers and other customers who furnish these funds as makers either of donations or contributions to the company. The transaction neither in form nor in substance bore such a semblance.
>
> *"The payments were to the customer the price of the service.* * * *" At pages 102-103.

It is respondent's position that the distinction as to why the present case is controlled by the *Brown Shoe* decision, rather than *Detroit Edison,* is that the payments in *Detroit Edison* were considered as income for services to be rendered, thus eliminating any basis for the recipient corporation to claim the payments as gifts or nongratuitous contributions to capital. This logical distinction was carried through as evidenced by the 1954 Internal Revenue Code Amendments. See discussion *infra* at pages 24-26.

Petitioner's argument and the dissenting opinion of the Court of Claims both err in confusing the statutory basis for respondent's claim. They stress lack of donative intent in the Federal Aid Highway Act to award any

gratuities to railroads. This would be relevant to a claim by a taxpayer based on Section 113(a)(2), providing for assumption of donor's basis in connection with gifts or gratuitous transfers.

However, the *Brown Shoe* decision was based on Section 113(a)(8)(B), the same subsection relied on by respondent, providing an exception to the general rule for nongratuitous transfers from nonshareholders. The distinction between the two subsections is the lack of any need to establish "donative intent" for claims based on Section 113(a)(8)(B). Petitioner fails to consider this vital distinction in asserting that donative intent is essential to this case.

C. Direct Effect And Purpose Of Contributions Made By Governmental Units Was To Increase Respondent's Working Capital.

In *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583, 586, at issue was the propriety of depreciation deductions on property acquired from proceeds of contributions made to the taxpayer to induce the company to locate or expand its operations in that community. The agreements between the communities and the taxpayer, in general, provided that the corporation would be granted a land site, railroad industrial tracks would be constructed, utility hookups would be provided, all city taxes would be rebated for 10 years and the City would grant $100,000 towards the cost of plant construction. The Brown Shoe Company agreed to build the plant with a minimum additional investment of $100,000 and to operate the plant for a minimum of 10 years. There was actually no obligation to replace any of the plant facilities unless required within the initial 10-year period.

In the present case, respondent is obligated to replace all equipment directly related to railroad use, thus more specifically giving rise to the accounting need to create a depreciation reserve to aid in anticipating the necessary replacement, than was present in the *Brown Shoe* case.

In *Brown Shoe,* this court, in holding that the taxpayer was entitled to depreciation deductions, stated at pp. 589-590:

> "We think the assets transferred to petitioner by the community groups represented 'contribution to capital' within the meaning of Section 113(a)(8)(B) and required no reduction in the depreciation basis of the properties acquired. The values which the taxpayer received were additions to 'capital' as that term has commonly been understood in both business and accounting practice; conformably with this usage the pertinent Treasury Regulations have consistently recognized that contributions to capital may originate with persons having no proprietary interest in the business. That this interpretation is in harmony with broad congressional policy as to depreciation deductions was emphasized by the Third Circuit when considering the similar situation presented in *Commissioner* v. *McKay Products Corp., supra,* 178 F. 2d at 643:
>
> > '* * * the assets received * * * are being used by the taxpayer in the operation of its business. They will in time wear out, and if (the taxpayer) is to continue in business, the physical plant must eventually be replaced. Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions—and especially those which provide for a substituted rather than a cost basis—would seem to envision allowance of a depreciation deduction in situations like this * * *.' "

In distinguishing the *Detroit Edison* case, this Court emphasized that the contributions were provided by communities "who neither sought nor could have anticipated any direct service of recompense whatever, the only expectation being such contributions might prove advantageous to the community at large." From these facts, the Court concluded that "the transfers manifested a definite purpose to enlarge the working capital of the company."

Much stress is placed by petitioner on distinguishing the purpose and intent of the contributions by the local communities in the *Brown Shoe* case from the contributions in this case. Actually, the important purposes, motives and intents in the *Brown Shoe* case and this case are parallel. For example, the contributions were not made for the purpose of obtaining goods, services, or privileges from the respondent. The contributions were made to benefit the public and had the effect of assuring the welfare and protection of the community at large. In *Brown Shoe,* one of the purposes of the contribution was to create employment opportunities for citizens of that community. In respondent's case the contributions were made by the federal government through local governmental units which also had the effect of increasing job opportunities during the depression era. (App. 91)

The substance of the transactions in the present case indicates more persuasively than in *Brown Shoe* an intent to enlarge respondent's working capital, since in the absence of the availability of such funds the rail safety facilities would frequently be ordered installed by State Public Service Commissions out of and in reduction of respondent's working capital. Therefore, the contributions

at issue from the Federal Highway Aid Program funded a preexisting and continuing capital obligation of respondent. That this was an intended effect of the Act is demonstrated by the method of allocating the Federal funds by the Bureau of Public Roads. The Bureau determined the allocation based on percentages of railroad miles within each state in order to benefit the working capital of the railroads in an equitable proportion. (App. 91) Although the primary purpose of the Act was to "expedite highway traffic flow" the Act also specifically contemplated contributions to railroads to reimburse them for rail safety facilities as a secondary purpose. *Under these circumstances,* the transfers to respondent and other railroads "manifested a definite purpose to enlarge their working capital."

In the *Brown Shoe* situation the recipient corporation had no preexisting capital obligation to construct new plant facilities in the local communities. Certainly the transfers to respondent manifested a purpose and had the effect of enlarging the respondent's capital which otherwise was subject to reduction for construction of rail safety facilities ordered by other governmental units.

One element of the intent can best be judged by the clear result which would flow from the contribution. As stated by the Trial Commissioner and the Court of Claims:

> "Defendant also says that the governmental payments for the facilities 'were not intended to be contributions to the capital of the railroad' but rather were 'part of the cost of the State in building its highway system'; and that the facilities are 'not re-

> lated to the production of income but rather to the safety of the local community.' No doubt, the principal purpose of the facilities was to benefit the community at large by providing improved safety at railroad highway intersections. But the fact remains that the facilities enlarged plaintiff's working capital and were used by plaintiff in its business; and though they may not produce income to the same extent as other railroad property, such as track or freight cars, plaintiff derived economic benefits from them." (Pet. 7a)

In the *Brown Shoe* case, 339 U.S. 583, there was no primary intention to enlarge the company's working capital. The local communities providing the property and funds were not directly interested in building up the capital of the Brown Shoe corporation, except to make more certain that jobs were created at their location, and the benefit to the community resulted. The welfare of the company was an incidental concern, as a means to the real public benefit purpose.

Similarly, in the present case, the public welfare was the real concern, and the benefit to respondent's working capital was secondary. But, in each case, the clear and recognizable result of the actions taken was also to increase the capital of the corporation.

As in *Brown Shoe*, the payments here involved "neither customers nor payments for service," 339 U.S. at 591. The Court found "under these circumstances" there was a definite purpose to enlarge the working capital of the company, and the circumstances were the ultimate public benefit sought by means of contributing to the company's capital.

In the present case, the structures and facilities were principally for the benefit of highway users, and not the contributors of the funds. But the contributions manifested a purpose, although secondary, to enlarge the working capital of respondent in the same sense as the contributions in the *Brown Shoe* case. The efforts of petitioner to show that in some way the present case is similar or should be controlled by the *Detroit Edison* case are untenable.

D. 1954 Internal Revenue Code Revisions Limited To Apply Prospectively Only From June 22, 1954.

Since many legal commentators believed that the effect of the *Brown Shoe* case was to overrule the *Detroit Edison* case,[10] legislative amendments were proposed which resulted in two new provisions in the Internal Revenue Code of 1954. This Court's holding in *Edwards v. Cuba Railroad*, 268 U.S. 628, was generally regarded as barring income recognition in situations similar to those present in the *Detroit Edison* case.

Therefore, in order to clarify the tax status of gifts or nongratuitous contributions to corporations, Congress added Sections 118 and 362(c) to the 1954 Internal Revenue Code. Section 118 provides that in the case of a corporation, "gross income is not to include any contribution to the capital of the taxpayer." As stated in the Senate Report:

> "This in effect places in the Code the court decisions on this subject. It deals with cases where a contribution is made to a corporation by a govern-

(10) See, The Supreme Court, 1949 Term, 64 Harvard Law Review 149-151 (1950).

> mental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to receive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services." (3 U.S. Code Congressional and Administrative News, 1954, page 4648)

Section 362(c) of the 1954 Code provides that contributions to capital made by nonstockholders after June 22, 1954 would have a basis of zero in the hands of the transferee and therefore no depreciation allowances would be available with respect to these assets.

The obvious purpose of Section 362(c) was to prospectively overcome the effect of the *Brown Shoe* decision. This is indicated in the House Report on this section which provides:

> "Subsection (c) has no counterpart under existing law and provides rules respecting situations similar to that which have occurred in the decision in *Brown Shoe Co.* v. *Commissioner,* (339 U.S. 583, 70 S. Ct. 820), where property was contributed to a corporation by persons other than its shareholders in their capacity as shareholders.
>
> "In such case, paragraph (1) of subsection (c) provides that if property, other than money, is acquired by a corporation after the date of enactment of this title as a contribution to capital and is not contributed by a shareholder as such, then the basis of such property shall be zero." (3 U.S. Code Congressional and Administrative News, 1954, page 4266)

This special rule adopted by the 1954 Code is well recognized as substantially enacting the position of the

Commissioner in the *Brown Shoe* case designed to apply prospectively to the type of situation there involved. *Veterans Foundation* v. *Commissioner of Internal Revenue,* 317 F. 2d 456, 458 (C.A. 10). Volume 3A, Mertens, *Law of Federal Income Taxation,* Section 21.134.

On the other hand, under Section 118, provision for nonrecognition of income has been interpreted as not applying to the initial payments made by direct beneficiaries of the service such as the potential customers of Detroit Edison. *Teleservice Co. of Wyo. Val.* v. *CIR,* 254 F. 2d 105, (C.A. 3) cert. denied, 357 U.S. 919.

The net effect of the 1954 Code amendments was to codify the rule sought by the Commissioner, but, by its own terms the amendments were made inapplicable to the depreciation deductions claimed by respondent in this case, which were on property acquired prior to June 22, 1954.

Apparently the Commissioner believes that the subsequent vindication of his position in the *Brown Shoe* case by a statutory revision should be applied retroactively. However framed, such a position cannot obscure its fundamental weakness from a legal standpoint. It is a basic rule that statutes will not be given retroactive effect unless required by explicit language or necessary implication. *Claridge Apartments* v. *Commissioner,* 323 U.S. 141, 164 (1944). Here the explicit statutory language clearly demonstrates that it is inapplicable to property acquired prior to its effective date. Therefore, respondent's right to depreciation deductions on the rail-highway safety facilities matured exclusively under Section 113 of the 1939 Code.

As demonstrated in this brief, Section 113 and the regulations issued thereunder clearly entitle respondent to claim the depreciation deductions on those rail safety facilities it was obligated to replace and which were acquired prior to June 22, 1954. The rationale of that section is based on a recognition that the depreciation deductions should accrue to the taxpayer who bears the risk of economic loss of the facilities and has the obligation of replacement.

II.

TERMS LETTER AGREEMENT BETWEEN RESPONDENT AND COMMISSIONER IS NO BAR TO RESPONDENT'S CLAIM FOR DEPRECIATION ALLOWANCES.

By letter dated April 20, 1945, respondent accepted a "terms letter" agreement with the Commissioner of Internal Revenue, regarding a changeover in the method of depreciation accounting for certain of its roadway property. Earlier the Commissioner had prepared a set of suggested general guidelines, referred to as "Mimeo 58", relating to changeovers in accounting methods. The Mimeo 58 guidelines were not incorporated into the terms letter agreement between respondent and Commissioner, and respondent was never asked to agree to them, as conditions or otherwise. In 1961, respondent affirmed the terms letter of 1945, but again Mimeo 58 was not made a part of the agreement. The terms letter made no reference to property received as a contribution, and provided that the provisions of the Code should be followed. The conditions of the agreement were made subject to change, as needed to conform to the law.

Mimeo 58 specifically provided that "the basis for depreciation shall be the cost of the existing depreciable property to the present taxpayer, determined in accordance with Sections 113 and 114(a) of the Internal Revenue Code." (App. 58) But it also listed certain types of property which the Commissioner did not regard as having a basis, including contributions to the capital of a corporation. This was in line with the Commissioner's then interpretation of the law.

It is respondent's position that there is no basis for regarding the Mimeo 58 guidelines as being part of or limiting the terms letter agreement. But even if the Mimeo 58 guidelines were considered part of the terms letter agreement, as noted by the Court of Claims:

> "The statement 'Donated property or contributions or grants in aid of construction from any source must be excluded' was only the opinion of the Service with respect to what constituted the basis allowable under the Code and does not rise to the level of a condition upon which permission to change depreciation methods would be granted. Ultimately, the Supreme Court determined that opinion to be erroneous in the case of *Brown Shoe Co.* v. *Commissioner*, *supra,* and held that, pursuant to Section 113(a)(8)(B) of the 1939 Code, a taxpayer was entitled to include in its basis for depreciation certain donated property." (Pet. 9a)

The terms letter agreement is no bar to including the rail safety facilities in respondent's depreciation base for the following reasons:

1. The applicability of Section 113(a)(8)(B) to contributions to capital by governmental units was authoritatively determined by this Court in *Brown Shoe Co.* v.

Commissioner, 339 U.S. 583, and takes precedence over the opinion of the Commissioner. That the Brown Shoe decision effectuated a change in the law is evidenced by the fact that prior to 1943 the Commissioner of Internal Revenue allowed depreciation deductions to the Brown Shoe Company based on then existing interpretations of Section 113 by the Internal Revenue Service. It was only subsequent to this Court's decision in *Detroit Edison* v. *Commissioner,* 319 U.S. 98 that the Commissioner commenced to disallow depreciation deductions on contributions to capital claimed by the Brown Shoe Company.[11] Thus during the period 1943-1950, the law as interpreted by the Commissioner of Internal Revenue was that Section 113 of the 1939 Code barred claims for depreciation deductions on contributions to capital similar to those made in the *Brown Shoe* case, as well as in the instant case.

Since the terms letter agreement between respondent and Commissioner was executed in 1945, it is obvious that the *Brown Shoe Case* in 1950 effectively overruled the Commissioner's position during the period from 1943-1950 and effectuated the change in the law which would qualify respondent to then claim depreciation deductions on these rail safety facilities, in accordance with the qualified acceptance in the terms letter agreement, as well as the Mimeo 58 guidelines.

The Commissioner of Internal Revenue recognized such priority in the same documents relied upon by the peti-

(11) See *Brown Shoe Co.* v. *Commissioner,* 339 U.S. 583, 588 where it is indicated that such was the practice of the Internal Revenue Service.

tioner. As indicated, the terms letter, which is the only agreement between the parties, specifically provided that "in the event that any of the terms and conditions stated in said letter should be changed by statutory amendment, by operation of law, or otherwise," respondent would not be precluded "from the benefits of any such changes" and would be "entitled to the benefit of any such changes regardless of the acceptance herein contained." (App. 55)

The letter of the Internal Revenue Service dated July 26, 1961, granting respondent permission to take advantage of the Retirement Straight Line Adjustment Act of 1958, 72 Stat. 1669, also provides that "it is mutually understood that complete depreciation accounting in accordance with all the applicable sections of the Internal Revenue Code and Regulations will be followed, and, where necessary, proper accounting adjustment shall be made * * *." (App. 68)

As stated by the Court of Claims:

> "The Supreme Court's decision in *Brown Shoe, supra,* distinguishing the case of *Detroit Edison, supra,* and holding that certain donated property could be added to the depreciable base, produced such a change in the conditions of the terms letter and plaintiff is entitled to the benefits thereof." (Pet. 10a)

The cases cited by petitioner regarding the irrevocability of terms letter agreements between the Commissioner and railroads regarding changeover from retirement to depreciation accounting are not applicable to the facts in the instant case because (a) they all are concerned with specific terms in a basic terms letter agreement itself and not to general references in the Mimeo 58

guidelines, and (b) they do not consider the effect of a subsequent change in law on their particular factual situations. See *Chicago, Milwaukee, St. Paul & Pacific R. Co.* v. *United States,* 404 F. 2d 960 (Ct. Cl., 1968); *Denver & Salt Lake Railway Co.* v. *Commissioner,* 24 T.C. 709; *Denver & Rio Grande Western Railroad Company* v. *Commissioner,* 32 T.C. 43, affirmed on other ground, 279 F. 2d 368 (C.A. 10).

2. Retirement accounting is a method recognized and accepted as proper by the Commissioner of Internal Revenue as a means of depreciation in lieu of the conventional ratable depreciation method. *Boston & Maine RR.* v. *Commissioner,* 206 F. 2d 617, 619 (C.A. 1, 1953). Retirement accounting involves the retention of assets on the books of a taxpayer at full value during their useful life rather than allowing annual adjustments for depreciation under the conventional ratable depreciation method.

The issue in this case is whether the respondent is entitled to any depreciation for rail safety facilities, installed from the proceeds of contributions to its capital, not whether they should be accounted for under retirement accounting or ratable depreciation.

It was recognized that "proper accounting" adjustments would be made from time to time, to comply with the law. One of these adjustments was to conform to the law as determined by the *Brown Shoe* decision in 1950. Proper procedures were followed so that respondent did not waive its right to claim this depreciation, and no relinquishment of such rights was made or intended.

It follows that if respondent is entitled to a depreciation basis under Section 113 of the 1939 Internal Revenue Code, neither the terms letter agreement nor the Mimeo 58 guidelines would bar respondent's claim. What was intended by the terms letter was to exclude property that was nondepreciable under the law. The language shows no intent to compel respondent to eliminate property which would otherwise be depreciable. By clear terms, respondent was to receive the benefit of any changes in the law, as understood at the time the agreement was signed. The Commissioner's recognition of this fact is evidenced in all the documents.

CONCLUSION.

For the reasons stated, the judgment of the Court of Claims should be affirmed.

Respectfully submitted,

Richard J. Schreiber
Robert T. Molloy
Rosslyn Building, North
1911 N. Fort Myer Drive
Arlington, Virginia 22209

Attorneys for Chicago. Burlington & Quincy Railroad Company

Robert E. Simpson
Richard T. Cubbage
Of Counsel

January 19, 1973

APPENDIX

Internal Revenue Code of 1939
(26 U.S.C. 1952 ed.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * *

(2) Gifts after December 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period prior to the date of the gift as provided in subsection (b)) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner.

* * *

Internal Revenue Code of 1954
(26 U.S.C.)

Sec. 118. Contributions to the Capital of a Corporation.

(a) General rule.—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

(b) Cross Reference.—For basis of property acquired by a corporation through a contribution to its capital, see section 362.

* * *

Sec. 362. Basis to Corporations.

* * *

(c) Special rule for certain contributions to capital.—

(1) Property Other than Money.—Notwithstanding subsection (a)(2), if property other than money—

(A) is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such, then the basis of such property shall be zero.

(2) Money.—Notwithstanding subsection (a) (2), if money—

(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such,
then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess (if any) of the amount of such contribution over the amount of the reduction under

the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer. The particular properties to which the reductions required by this paragraph shall be allocated shall be determined under regulations prescribed by the Secretary or his delegate.

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED STATES *v.* CHICAGO, BURLINGTON & QUINCY RAILROAD CO.

CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

No. 72-90. Argued February 26, 1973—Decided June 4, 1973

In this refund suit, respondent railroad seeks to recover an alleged income tax overpayment resulting from its failure to take deductions for depreciation with respect to the cost of facilities constructed at highway-railroad intersections and elsewhere that were paid for, not by respondent, but out of Government funds appropriated to further public safety and improve highway systems. Respondent claimed that the subsidies qualified as contributions to its capital by a nonshareholder under § 113 (a)(8) of the Internal Revenue Code of 1939, thereby permitting respondent to depreciate the Government's cost in the assets. The Court of Claims ruled that respondent was entitled to the claimed depreciation deduction. *Held:* The governmental subsidies did not constitute contributions to respondent's capital within the meaning of § 113 (a)(8); the assets in question have a zero basis; and respondent cannot claim a depreciation allowance with respect to those assets. As can be gleaned from *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, and *Brown Shoe Co.* v. *Commissioner,* 339 U. S. 58, to qualify as a nonshareholder contribution to capital, the asset must become a permanent part of the transferee's working capital structure; may not be compensation for the transferee's services; must be bargained for; must benefit the transferee commensurately with its value; and ordinarily will be used to produce additional income. Here, almost none of these criteria was met, since the facilities were not bargained for and, but for the governmental subsidies, would not have been constructed. No substantial incremental benefit in terms of income production was considered at the time the facilities were transferred, and such minor benefit as may have accrued to respondent from the

Syllabus

facilities was merely peripheral to the railroad's business. Nor would respondent's asserted obligation to replace the facilities warrant the claimed depeciation. Pp. 4–15.

197 Ct. Cl. 264, 455 F. 2d 993, reversed and remanded.

BLACKMUN, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, WHITE, MARSHALL, and REHNQUIST, JJ., joined. DOUGLAS, J., filed a dissenting opinion. STEWART, J., filed a dissenting opinion, in which DOUGLAS, J., joined. POWELL, J., took no part in the consideration or decision of the case.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 72-90

United States, Petitioner, v. Chicago, Burlington & Quincy Railroad Company.	On Writ of Certiorari to the United States Court of Claims.

[June 4, 1973]

Mr. Justice Blackmun delivered the opinion of the Court.

The issue in this federal income tax case is whether the respondent, Chicago, Burlington & Quincy Railroad Company (CB&Q), an interstate common carrier railroad, may depreciate the cost of certain facilities paid for prior to June 22, 1954, not by it or by its shareholders, but from public funds.

Starting about 1930, CB&Q entered into a series of contracts with various Midwestern States. By these agreements the States were to fund some or all of the costs of construction of specified improvements, and the railroad apparently was to bear, at least in part, the costs of maintenance and replacement of the improvements once they had been installed. In 1933, as part of the program of the National Industrial Recovery Act, 48 Stat. 195, Congress authorized federal reimbursement to the States of the shares of the costs the States incurred in the construction of those improvements that inured to the benefit of public safety and improved highway traffic control.[1] In 1944 Congress went further and authorized

[1] National Industrial Recovery Act, § 204 (a)(1), 48 Stat. 203 (1933).

reimbursement, with stated limitations, to the States for the entire cost of the improvements, subject to the condition that a railroad that received a benefit from a facility so constructed was liable to the Government for up to 10% of the cost of the project pro rata in relation to the benefit received by the railroad.[2]

Under these programs CB&Q received, at public expense, highway undercrossings and overcrossings having a cost of $1,538,543; crossing signals, signs, and floodlights having a cost of $548,877; and jetties and bridges having a cost of $58,721.[3] These improvements, aggregating $2,146,141, were carried on the railroad's books as capital assets even though most of the agreements between CB&Q and the several States did not expressly convey title to the railroad.

CB&Q instituted a timely suit in the Court of Claims alleging, among other things, that it had overpaid its 1955 federal income tax because it had failed to assert, as a deduction on its return as filed, allowable depreciation on the subsidized assets.[4] By a 4-to-3 decision on this issue (only one of several in the case), the Court of Claims concluded that, under § 167 of the Internal Rev-

---

[2] Federal-Aid Highway Act of 1944, § 5, 58 Stat. 838, 840–841.

[3] The Court of Claims, both the majority and dissenters, asserted, and indeed found, that the $1,538,543 figure related to highway undercrossings and overcrossings. 197 Ct. Cl. 264, 271–272, 325, 455 F. 2d 993, 997–998 (1972). CB&Q, in its Brief, p. 3, and in oral argument, Tr. of Oral Arg. 25, claims that this figure has to do only with railroad bridges and that the assets sought to be depreciated relate only to railroad use. According to CB&Q, no facilities directly related to highway use are involved. Inasmuch as the resolution of this factual issue would not affect the result we reach, it need not be resolved.

[4] The parties are in agreement as to what the adjusted bases of the assets in question would be, and as to the applicable rates of depreciation, if depreciation for tax purposes is allowable at all.

enue Code of 1954, 26 U. S. C. § 167, CB&Q was entitled to the depreciation deduction it claimed. This was on the theory that the subsidies qualified as contributions to the railroad's capital under §§ 362 and 1052 (c) of that Code, 26 U. S. C. §§ 362 and 1052 (c), and under § 113 (a)(8) of the Internal Revenue Code of 1939.

In arriving at this conclusion, the Court of Claims majority relied on *Brown Shoe Co.* v. *Commissioner*, 339 U. S. 583 (1950), and reasoned that even though the governmental payments for the facilities may not have been intended as contributions to the railroad's capital, the "principal purpose" being, instead, "to benefit the community-at-large," 197 Ct. Cl., at 276, 455 F. 2d, at 1000, the facilities did in fact enlarge the railroad's working capital, were used in its business, and produced economic benefits for it, thereby qualifying as contributions to its capital under the cited section of the 1939 Code. The three dissenting judges disagreed with this interpretation of *Brown Shoe*, and, instead, relied on *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98 (1943). They concluded that the critical features were the donor's attitude, purpose, and intent, and that, with governmental payments, there could be no intention to confer a benefit upon CB&Q. Instead, as the findings revealed,[5] the intention was to expedite traffic flow and to improve public safety at highway-railroad crossings. 197 Ct. Cl., at 315, 320, 455 F. 2d, at 1023, 1026.

---

[5] The Trial Commissioner and the Court of Claims made the following finding of fact:

"9. The facilities noted in finding 7 were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow. Plaintiff [CB&Q], however, received benefits from the facilities, among others, probable lower accident rates, reduced expenses of operating crossing facilities, and, where permitted, higher train speed limits, all of which permitted plaintiff to function more efficiently and presumably less expensively." 197 Ct. Cl., at 326–327.

Because the Court of Claims decision apparently would afford a precedent for the tax treatment of substantial sums,[6] we granted certiorari. 409 U. S. 947.

I

Section 23 (*l*) of the 1939 Code and its successor, § 167 (a) of the 1954 Code, 26 U. S. C. § 167 (a), allow a taxpayer "as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear . . . of property used in the trade or business." In the usual situation the taxpayer itself incurs cost in acquiring the asset as to which the depreciation deduction is asserted.[7] But there are other and different situations formally recognized in the governing tax statutes. A familiar example is gift property.[8] Another is property acquired by a cor-

[6] The Solicitor General asserts, Petition for Certiorai 15–16, that $623,000,000 in federal funds were paid out for projects and improvements at railroad-highway grade crossings alone between 1934 and 1954. See U. S. Department of Transportation, Report to Congress: Railroad-Highway Safety, Part I: A Comprehensive Statement of the Problem 38 (1971). The Commissioner of Internal Revenue estimates that, taking into account grants of this kind to railroads and federal grants to utility companies, depreciation on property with asserted cost bases between a half billion and one billion dollars is dependent upon the resolution of this issue and is still litigable. Petition for Certiorari 16.

[7] Section 113 (a) of the 1939 Code and § 1012 of the 1954 Code, 26 U. S. C. § 1012, state the general rule that the "basis of property shall be the cost of such property."

[8] Section 113 (a)(2) of the 1939 Code provides that with respect to "property . . . acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except . . . ." This provision was carried over into § 1015 (a) of the 1954 Code, 26 U. S. C. § 1015 (a). The language of § 362 (c) of the 1954 Code, to the effect that the basis of a nonshareholder's contribution made on or after June 22, 1954, to the capital of a corporation shall be zero in the hands of the transferee, has been said not to affect the availability of a carryover basis with respect

poration from its shareholders as paid-in surplus or as a contribution to capital.[9] Another, and the one that is pertinent here, is covered by § 113 (a)(8) [10] of the 1939 Code and by the contrasting provisions of §§ 362 (a) and (c) of the 1954 Code, 26 U. S. C. §§ 362 (a) and (c).[11]

---

to gifts. See H. R. Rep. No. 1337, 83d Cong., 2d Sess., A128 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess., 272 (1954); B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders, ¶ 3.14, pp. 3–51 and n. 81 (3d ed. 1971); 3A J. Mertens, Law of Federal Income Taxation, § 21.134 (1968 rev.).

[9] Section 113 (a)(8) of the 1939 Code; § 362 (a) of the 1954 Code, 26 U. S. C. § 362 (a).

[10] "§ 113. Adjusted basis for determining gain or loss—

"(a) Basis (unadjusted) of property.

"The basis of property shall be the cost of such property; except that—

. . . . .

"(8) Property acquired by issuance of stock or as paid-in surplus.

"If the property was acquired after December 31, 1920, by a corporation—

"(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

"(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made."

[11] "§ 362. Basis to corporations.

"(a) Property acquired by issuance of stock or as paid-in surplus.

"If property was acquired on or after June 22, 1954, by a corporation—

"(1) in connection with a transaction to which section 351 (relating to transfer of property to corporation controlled by transferor) applies, or

"(2) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the trans-

This concerns a contribution to capital by a nonshareholder. See Treas. Reg. 111, § 29.113 (a)(8)-1 (1943). Under §§ 113 (a)(8) and 114 (a) of the earlier Code, the nonshareholder-contributed asset in the hands of the receiving corporation had the same basis, subject to adjustment, for depreciation purposes as it had in the hands of the transferor; under the 1954 Code, however, its basis for the transferee is zero.

Pertinent to all this is the Court's decision in *Edwards* v. *Cuba Railroad,* 268 U. S. 628 (1925). The Court there held that subsidies granted by the Cuban Government to a railroad to promote construction in Cuba "were not profits or gains from the use or operation of the railroad," and did not constitute income to the receiving corporation. 268 U. S., at 633. The holding in *Edwards,* taken with § 113 (a)(8) of the 1939 Code, produced a seemingly anamolous result, for it meant that a corporate taxpayer receiving property from a nonshareholder as a contribution to capital not only received the property

---

feror, increased in the amount of gain recognized to the transferor on such transfer.

. . . .

"(c) Special rule for certain contributions to capital.

"(1) Property other than money.

"Notwithstanding subsection (a)(2), if property other than money—

"(A) is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

"(B) is not contributed by a shareholder as such, then the basis of such property shall be zero.

"(2) Money.

"Notwithstanding subsection (a)(2), if money—

"(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

"(B) is not contributed by a shareholder as such, then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution."

free from income tax but was allowed to assert a deduction for depreciation on the asset so received tax free. This result also ensued under the Court's holding in *Brown Shoe* and led to the enactment of the zero basis provision, referred to above, in § 362 (c) of the 1954 Code, 26 U. S. C. § 362 (c). *Veterans Foundation* v. *Commissioner,* 317 F. 2d 456, 458 (CA10 1963).

CB&Q argues that this very result should follow here. It is said that the railroad received no taxable income and incurred no income tax liability when it received, at governmental expense prior to June 22, 1954, the facilities as to which CB&Q now asserts depreciation. And, in providing the facilities, CB&Q argues, the Government intended to make a contribution to the railroad's capital, within the meaning of § 113 (a)(8), thereby permitting CB&Q to depreciate the Government's cost in the assets. Whether the governmental subsidies qualified as income to the railroad is an issue not raised in this case, and we intimate no opinion with respect to it. The United States, however, asserts that the subsidies did not constitute a "contribution to capital" under § 113 (a)(8), and that, accordingly, the transferee railroad's tax basis is zero and no depreciation deduction is available.

Our inquiry, therefore, is a narrow one: whether the nonshareholder payment in this case constituted a "contribution to capital," within the meaning of § 113 (a)(8). Because both *Detroit Edison* and *Brown Shoe* bear upon the issue, we turn to those two decisions.

II

Detroit Edison concerned customers' payments to a utility for the estimated costs of construction of service facilities (primary power lines) that the utility otherwise was not obligated to provide. For its tax years 1936 and 1937, to which the Revenue Act of 1936, 49 Stat. 1648, applied, the utility claimed the full cost of the facilities

in its base for computing depreciation. The Commissioner disallowed, for depreciation purposes, that portion of the cost paid by customers and not refundable. The Board of Tax Appeals, 45 B. T. A. 358 (1941), and the Court of Appeals, 131 F. 2d 619 (CA6 1942), sustained the Commissioner. This Court affirmed.

Mr. Justice Jackson, speaking for a unanimous Court (the Chief Justice not participating), observed, "The end and purpose of it all [depreciation] is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets." 319 U. S., at 101. The statute, § 113 (a) of the 1936 Act, it was said, "means . . . cost to the taxpayer," even though the property "may have a cost history quite different from its cost to the taxpayer." Also, the "taxpayer's outlay is the measure of his recoupment through depreciation accruals." 319 U. S., at 102. The utility's attempt to avoid this result by its contention that the payments were gifts or contributions to its capital, and entitled to the transferors' bases, was rejected.

> "It is enough to say that it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. The transaction neither in form nor in substance bore such a semblance.
>
> "The payments were to the customer the price of the service. . . . They have not been taxed as income. . . . But it does not follow that the Company must be permitted to recoup through untaxed depreciation accruals on investment it has refused to make." 319 U. S., at 102–103.

Detroit Edison, by itself, would appear almost to foreclose CB&Q's claims here, for there is an obvious parallel

between the customers' payment for the utility service facilities in *Detroit Edison,* and the governmental payments for improvements to the railroad's service facilities in the case before us.

But *Detroit Edison* was not the last word. *Brown Shoe* was decided seven years later, and the opposite tax result was reached by an 8–1 vote of the Court, with Mr. Justice Black in dissent without opinion.

Brown Shoe concerned a corporate taxpayer's excess profits tax, under the Second Revenue Act of 1940, 54 Stat. 974, as amended, for its fiscal years 1942 and 1943. Community groups paid cash or transferred property to the taxpayer as an inducement for the location or expansion of factory operations in their communities. Contracts were entered into, and in each instance the taxpayer obligated itself to locate or enlarge a facility in the community and to operate it for at least a minimum term. The value of the payments and transfers were the focus of the controversy between the taxpayer and the Commissioner, for depreciation on the transferred assets was claimed and their inclusion in equity invested capital was asserted. The Tax Court overruled the Commissioner's disallowance with respect to the acquisitions paid for with cash but sustained the Commissioner with respect to buildings transferred. 10 T. C. 291 (1948). The Court of Appeals upheld the Commissioner on both items. 175 F. 2d 305 (CA8 1949). This Court reversed.

Mr. Justice Clark, writing the opinion for the majority of the Court, concluded that the assets transferred by the community groups to the taxpayer were contributions to capital, within the meaning of § 113 (a)(8) of the 1939 Code. The Court noted that in time they would wear out and, if the taxpayer continued in business, the physical plant eventually would have to be replaced. *Detroit Edison* was cited and recognized, but was considered not to be controlling. In *Brown Shoe* there were

"neither customers nor payments for service," and therefore the Court "may infer a different purpose in the transactions between petitioner and the community groups." 339 U. S., at 591. The only expectation of the groups was that "such contributions might prove advantageous to the community at large." Thus, it was said, "the transfers manifested a definite purpose to enlarge the working capital of the company." *Ibid.*

The Court thus professed to distinguish and not at all to overrule *Detroit Edison.* It did so on an analysis of the purposes behind the respective transfers in the two cases. Where the facts were such that the transferors could not be regarded as having intended to make contributions to the corporation, as in *Detroit Edison,* the assets transferred were not depreciable. But where the transfers were made with the purpose not of receiving direct service or recompense but only of obtaining advantage for the general community, as in *Brown Shoe,* the result was a contribution to capital.

III

It seems fair to say that neither in *Detroit Edison* nor in *Brown Shoe* did the Court focus upon the use to which the assets transferred were applied, or upon the economic and business consequences for the transferee corporation. Instead, the Court stressed the intent or motive of the transferor and determined the tax character of the transaction by that intent or motive. Thus, the decisional distinction between *Detroit Edison* and *Brown Shoe* rested upon the nature of the benefit to the transferor, rather than to the transferee, and upon whether that benefit was direct or indirect, specific or general, certain or speculative.[12] These factors, of course, are simply indicia of the transferor's intent or motive.

---

[12] See for example, *Teleservice Co.* v. *Commissioner,* 254 F. 2d 105 (CA3), cert. denied, 357 U. S. 919 (1959); *United Grocers, Ltd.*

That this line of inquiry, and these distinctions, have relatively little to do with the economic and business consequences of the transaction seems self-evident.[13] In both cases the assets transferred were actually used in the transferee's trade or business for the production of income. In neither case did the transferee provide the investment for the assets sought to be depreciated. Yet in both cases, the assets in question were transferred for a consideration pursuant to an agreement. If, at first glance, *Detroit Edison* and *Brown Shoe* seem somewhat inconsistent, they may be reconciled, and indeed must be, on the ground that in *Detroit Edison* the transferor intended no contribution to the transferee's capital, whereas in *Brown Shoe* the transferors did have that intent.

The statutory phrase "contribution to capital" is nowhere expressly defined in either the 1939 Code or the 1954 Code, and our prior decisions provide only limited guidance as to its precise meaning. *Detroit Edison* might be said to be only a holding that a payment for services is not a contribution to capital. *Brown Shoe*

---

v. *United States*, 308 F. 2d 634 (CA9 1962). There is support in the legislative history of § 118 of the 1954 Code, 26 U. S. C. § 118, providing for the exclusion from gross income of "any contribution to the capital of the taxpayer," for the indirect benefit—prepayment-for-future-services distinction. H. R. Rep. No. 1337, 83d Cong., 2d Sess., 17 (1954).

[13] The distinctions wrought by *Detroit Edison* and *Brown Shoe* have been the subject of scholarly criticism. See, for example, Note, Taxation of Nonshareholder Contributions to Corporate Capital, 82 Harv. L. Rev. 619 (1969); Landis, Contributions to Capital of Corporations, 24 Tax L. Rev. 241 (1969); Note, Tax Consequences of Non-Shareholder Contributions to Corporate Capital, 66 Yale L. J 1085 (1957); Freeman & Speiller, Tax Consequences of Subsidies to Induce Business Location, 9 Tax. L. Rev. 255 (1954). In the article last cited the authors suggest that *Detroit Edison* and *Brown Shoe* are irreconcilable, the latter in effect overruling the former. *Id.*, at 262. See also The Supreme Court, 1949 Term, 64 Harv. L. Rev. 114, 149–151 (1950).

sheds little additional light, for the Court stated only that because the community payments were not compensation for specific services rendered, and did not constitute gifts, they must have been made in order to enlarge the working capital of the company. 339 U. S., at 591.

But other characteristics of a contribution to capital are implicit in the two cases and become apparent when viewed in the light of the facts presently before us. In *Brown Shoe,* for example, the contributed funds were intended to benefit not only the transferors but the transferee as well, for the assets were put to immediate use by the taxpayer for the generation of additional income. Without benefit to the taxpayer, the agreement certainly would not have been made. Perhaps to some extent this was true in *Detroit Edison;* that taxpayer, however, was a public utility, and the anticipated revenue from the service lines to the customers would not have warranted the investment by the utility itself. 319 U. S., at 99. Its benefit, therefore, was marginal.

We can distill from these two cases some of the characteristics of a nonshareholder contribution to capital under the Internal Revenue Codes. It certainly must become a permanent part of the transferee's working capital structure. It may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. It must be bargained for. The asset transferred foreseeably must result in benefit to the transferee in an amount commensurate with its value. And the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

By this measure, the assets with which this case is concerned clearly do not qualify as contributions to capital. Although the assets were not payments for

specific, quantifiable services performed by CB&Q for the Government as a customer, other characteristics of the transaction lead us to the conclusion that, despite this, the assets did not qualify as contributions to capital. The facilities were not in any real sense bargained for by CB&Q. Indeed, except for the orders by state commissions and the governmental subsidies, the facilities most likely would not have been constructed at all.[14] See *Nashville, C. & St. L. R. Co.* v. *Walters*, 294 U. S. 405, 421–424 (1935). The transaction in substance was unilateral: CB&Q would accept the facilities if the Government would require their construction and would pay for them. Any incremental economic benefit to CB&Q from the facilities was marginal; its extent and importance were indicated and accounted for by the requirement that the railroad pay not to exceed 10% of the cost in relation to its own benefit.[15] The facilities were peripheral to its business and did not materially contribute to the production of further income by the railroad. They simply replaced existing facilities or provided new, better, and safer ones where none otherwise would have been deemed necessary. As the Court of Claims found, the facilities were constructed "primarily for the benefit of the public to improve safety and to expedite highway traffic flow," [16] and the need of the railroad for capital funds was not considered, 197 Ct. Cl., at 326. While some incremental benefit from lower accident rates, from reduced expenses of operating crossing facilities, and from possibly higher train speed might have

---

[14] Counsel for CB&Q stated at oral argument that the railroad was under a "preexisting legal obligation to construct these facilities" that were funded by the governmental subsidies. Tr. of Oral Arg. 30, 35–36.

[15] The Government does not challenge the CB&Q's right to depreciate those portions of a facility for which it was required to pay.

[16] See n. 5, *supra*.

resulted, these were incidental and insubstantial in relation to the value now sought to be depreciated, and they were presumably considered in computing the railroad's maximum 10% liability under the Act. In our view, no substantial incremental benefit in terms of the production of income was foreseeable or taken into consideration at the time the facilities were transferred. Accordingly, no contribution to capital was effected.

CB&Q nevertheless contends that it is entitled to depreciate the facilities because of its obligation to maintain and replace them. Whatever may be the desirability of creating a depreciation reserve under these circumstances, as a matter of good business and accounting practice, the answer is, as Judge Davis of the Court of Claims observed in dissent, 197 Ct. Cl., at 318, 455 F. 2d, at 1025, "Depreciation reflects the cost of an existing capital asset, not the cost of a potential replacement." *Reisinger* v. *Commissioner*, 144 F. 2d 475, 478 (CA2 1944). See *United States* v. *Ludey*, 274 U. S. 295, 300–301 (1927); *Weiss* v. *Wiener*, 279 U. S. 333, 335–336 (1929); *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, 254 (1939); *Massey Motors* v. *United States*, 364 U. S. 92 (1960); *Fribourg Nav. Co.* v. *Commissioner*, 383 U. S. 272 (1966).

We conclude that the governmental subsidies did not constitute contributions to CB&Q's capital, within the meaning of § 113 (a)(8) of the 1939 Code; that the assets in question in the hands of CB&Q have a zero basis, under §§ 113 and 114 of that Code and § 1052 (c) of the 1954 Code, 26 U. S. C. § 1052 (c); and that CB&Q is therefore precluded from claiming a depreciation allowance with respect to those assets.[17] The judgment of the

[17] The Government has argued, in the alternative, that, by virtue of a terms letter agreement entered into by CB&Q and the Commissioner with respect to a change in the railroad's accounting method from retirement to straight-line depreciation, CB&Q irrevocably

Court of Claims on this issue is reversed and the case is remanded for further proceedings.

It is so ordered.

MR. JUSTICE POWELL took no part in the consideration or decision of this case.

---

agreed to exclude donated property, or contributions or grants in aid of construction from any source, from its depreciation base. Because of our conclusion that the governmental payments did not qualify as contributions to capital, we need not determine whether the terms letter agreement barred CB&Q from claiming depreciation on the assets in question.

SUPREME COURT OF THE UNITED STATES

No. 72-90

United States, Petitioner, *v.* Chicago, Burlington & Quincy Railroad Company.	On Writ of Certiorari to the United States Court of Claims.

[June 4, 1973]

MR. JUSTICE DOUGLAS, dissenting.

While I join the dissent of MR. JUSTICE STEWART, I add a few words. Funds were contributed by the States and by the Federal Government to respondent for the construction of highway overpasses and underpasses and for grade-crossing protection equipment. While the Government provided most of the funds, the respondent did most of the construction work—all as found by the Court of Claims. 455 F. 2d 993, 997–998.

This case is not controlled by *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, as MR. JUSTICE STEWART says, for there the advances were made by customers of a utility as part of "the price of the service." *Id.*, at 103. Here, however, the situation was different. As the Court of Claims found

> ". . . under all the agreements, plaintiff was obligated to maintain and replace as necessary, at its own expense, facilities originally built. The facilities were constructed primarily for the benefit of the public to improve safety and to expedite motor-vehicle traffic flow. The record shows, however, that plaintiff received economic benefits from the facilities, *e. g.*, probable lower accident rates, reduced expenses of operating crossing equipment and, where

permitted, higher train speed limits. Plaintiff also recevied intangible benefits, *e. g.*, goodwill from the community-at-large, which was to plaintiff's long-term economic advantage." 455 F. 2d, at 998.

The case is therefore on all fours with *Brown Shoe Co.* v. *Commissioner*, 339 U. S. 583. In distinguishing *Detroit Edison* we said:

> "Since in this case there are neither customers nor payments for service, we may infer a different purpose in the transactions between petitioner and the community groups. The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. Under these circumstances the transfer manifested a definite purpose to enlarge the working capital of the company." *Id.*, at 591.

I would affirm the judgment of the Court of Claims.

SUPREME COURT OF THE UNITED STATES

No. 72-90

United States, Petitioner, v. Chicago, Burlington & Quincy Railroad Company. | On Writ of Certiorari to the United States Court of Claims.

[June 4, 1973]

MR. JUSTICE STEWART, with whom MR. JUSTICE DOUGLAS joins, dissenting.

This case involves the depreciation of certain railroad facilities constructed with public funds prior to June 22, 1954. The precise question before the Court is whether those facilities constituted "contributions to capital" within the meaning of § 113 (a)(8)(B) of the Internal Revenue Code of 1939.

Beginning in the early 1930's, various state governments entered into agreements with the respondent railroad for the construction of highway overpasses and underpasses at highway-railroad intersections, and construction of grade crossing protection equipment such as flashing light signals and automatic gates. The agreements generally provided that the States would pay 50% or more of the total cost, and subsequently Congress authorized the Federal Government to assume the State's share of the construction costs. See National Industrial Recovery Act § 204 (a), 48 Stat. 195, 203. Under the Federal-Aid Highway Act of 1944, § 5, 58 Stat. 838, 840, the Federal Government reimbursed the States for the entire cost of the highway-railroad crossing projects, subject to payment by the railroads for up to 10% of the cost of the project if the railroads were benefited by the facilities.

The respondent filed suit in the Court of Claims seeking a refund on its 1955 income taxes, claiming that the Commissioner of Internal Revenue had erred by refusing to allow a depreciation deduction for these publicly-contributed facilities. The respondent asserted that these facilities were "depreciable property" held throughout 1955 "for use in its trade or business," and that they were acquired prior to June 22, 1954, as "contributions to capital."

The respondent's claim was an uncomplicated one. Section 167 of the Internal Revenue Code of 1954, 26 U. S. C. § 167, applicable to the respondent's 1955 income tax return, allowed as a depreciation deduction "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business. . . ." Section 1052 (c) of the 1954 Code, 26 U. S. C. § 1052 (c), provided for using the basis rules of the 1939 Code for certain property that was acquired in transactions to which the 1939 Code applied, including "contributions to capital." [1] The respondent contended that the publicly-contributed facilities were "contributions to capital," and that under § 113 (a)(8)(B) of the 1939 Code, it could carry-over the transferor's basis; in short, it claimed that its basis for the highway-safety facilities was the cost of the facilities to the governments that had financed them.[2]

[1] The basis provision of the 1954 Code, which provides a zero basis for nonshareholder contributions to capital, applies only to property acquired on or after June 22, 1954. 26 U. S. C. § 362. See n. 9, *infra*. All the property at issue in the present case was acquired before June 22, 1954.

[2] Section 113 (a)(8) provides in pertinent part:

"If the property was acquired after December 31, 1920, by a corporation—

. . . . .

"(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor,

The Court of Claims agreed with the respondent that these facilities were exhaustible assets properly depreciable to the full extent of their value. 455 F. 2d 993, 1002. The depreciable nature of the facilities was undisputed, since the Government conceded that "the facilities are of a character normally subject to allowance for depreciation and that to the extent they were paid for by [the respondent], appropriate depreciation deductions are proper." *Id.*, at 999. The Court concluded that the facilities were "contributions to capital" under § 113 (a)(8)(B) of the 1939 Code and that the Government's cost basis in the facilities was, therefore, available to the respondent.[3] "The facilities were constructed primarily for the benefit of the public to improve safety and to expedite motor-vehicle traffic flow. The record shows, however, that [the respondent] received economic benefits from the facilities, *e. g.*, probable lower accident rates, reduced expenses of operating crossing equipment and, where permitted, higher train speed limits. [The respondent] also received intangible benefits, *e. g.*, goodwill from the community-at-large, which was to [the respondent's] long-term economic advantage." *Id.*, at 998.[4] The Court thus concluded "that the facilities en-

---

increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made."

[3] It was undisputed that the facilities had been "contributed" to the respondent by the States, "and this is taken to mean that [the respondent] owns them. . . ." 455 F. 2d, at 998.

[4] The Findings of Fact of the Trial Commissioner which were accepted by the Court indicated as follows:

"The facilities . . . were constructed primarily for the benefit of the public to improve safety and to expedite highway traffic flow. [The respondent], however, received benefits from the facilities, among others, probable lower accident rates, reduced expenses of operating crossing facilities, and, where permitted, higher train speed limits, all of which permitted [the respondent] to function more

larged [the respondent's] working capital and were used by the respondent in its business; and though they may not produce income to the same extent as other railroad property, such as track or freight cars, [the respondent] derived economic benefits from them." *Id.*, at 1000.

I think the Court of Claims was entirely right in holding that these publicly-contributed facilities constituted contributions to capital within the meaning of § 113 (a)(8)(B) the 1939 Code.[5] The facilities at issue fall within the plain language of a "contribution to capital." As the Court noted, they were "contributed" to the respondent in the sense that the railroad now owns them. And they are now part of the "capital" of the railroad as that term is generally used in business and accounting practice, part of the permanent investment in the business. See *Brown Shoe Co.* v. *Commissioner*, 339 U. S. 583, 589 and n. 11; *Texas & Pac. R. Co.* v. *United States*, 286 U. S. 285; *Edwards* v. *Cuba R. Co.*, 268 U. S. 628, 631–633; H. Guthmann & H. Dougall, Corporate Financial Policy (4th ed.) 136–138; R. Marple, Capital Surplus and Corporate Net Worth 136–137; 1 J. Mertens, Law of Federal Income Taxation § 5.06 n. 47 (Malone rev. ed.); Harvey, Some Indicia of Capital Transfers Under the Federal Income Tax Laws, 37 Mich. L. Rev. 745, 747–749.[6]

---

efficiently and presumably less expensively." 197 Ct. Cl. 264, 326–327.

[5] The Government has suggested as an alternative basis for reversal that the respondent entered into a terms letter agreement with the Commissioner whereby it agreed to exclude contributed property from its depreciation base. The Court does not reach this contention. I agree with the reasoning of the Court of Claims in holding that the terms letter did not bar the respondent from claiming a depreciation deduction on contributed property.

[6] The text of § 113 indicates that there is no significance in the fact that the State and Federal Governments attempted here to achieve the public goal of transportation safety rather than simply

The only two prior decisions of this Court that bear directly on the question before us—*Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, and *Brown Shoe Co.* v. *Commissioner, supra*—confirm that these publicly contributed facilities are contributions to the respondent's capital.

In *Detroit Edison Co.* v. *Commissioner, supra*, prospective customers of an electric company were required to pay for the construction of additional facilities in order to receive the company's services. The Court rejected the contention that those payments were contributions to capital: "[I]t overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. . . . The payments were to the customer the price of the service." *Id.*, at 102–103.

In *Brown Shoe, supra*, various community groups contributed cash and property to the taxpayer corporation to induce it to locate in or expand its operations in the respective communities. The Court held these assets to be "contributions to capital" within the meaning of § 113 (a)(8)(B), stressing the fact that they were in a very practical sense an addition to the corporation's capital: ". . . the assets received . . . are being used by the taxpayer in the operation of its business. They

---

to make a gratuitous transfer to the railroad. For if a donative purpose were required for a "contribution to capital" then that provision would simply be duplicative of § 113 (a)(2) of the 1939 Code which allows a carryover basis for gifts.

And similarly it is of no consequence that the contribution was by a nonshareholder, for a contribution by a shareholder would have a carryover basis under the "paid-in surplus" provision of § 113 (a)(8)(B). See Treas. Reg. 111, § 29.113 (a)(8)–1.

In short, a "contribution to capital" is any nongratuitous transfer to a corporation by a nonshareholder, such as is involved in the present case. See Freeman & Speiller, Tax Consequences of Subsidies to Induce Business Location, 9 Tax L. Rev. 255, 261.

will in time wear out, and if [the taxpayer] is to continue in business, the physical plant must eventually be replaced. Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions—and especially those which provide for a substituted rather than a cost basis—would seem to envision allowance of a depreciation deduction in situations like this. . . ." *Id.*, at 590 (quoting *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, 643). The Court explained *Detroit Edison* as a case of payments for services rather than contributions to capital. By contrast, in *Brown Shoe*, "[t]he contributions to [the taxpayer] were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large." *Id.*, at 591.[7]

It seems plain to me that the present case is controlled by *Brown Shoe*. As in that case, these publicly-contributed facilities were in no sense direct payments for services. The State and Federal Governments did not purchase any services in connection with construction of the facilities. Rather, to achieve the public goal of transportation safety they transferred assets to the railroad which increased its working capital. In short, these assets fell within the practical, working definition of "contributions to capital" that was recognized by the Court in *Brown Shoe*, and they did not fall within the

[7] Federal courts in distinguishing between *Brown Shoe* and *Detroit Edison* have relied on the fact that *Detroit Edison* involved direct payments by customers for services. See *United Grocers, Ltd.* v. *United States*, 308 F. 2d 634, 639–640; *Teleservice Co.* v. *Commissioner*, 254 F. 2d 105, 110–111. See also Note, Taxation of Nonshareholder Contributions to Corporate Capital, 82 Harv. L. Rev. 619, 626–627.

narrow exception of payments for services that the Court found significant in *Detroit Edison.*

The Government urges us to read *Brown Shoe* as holding that, in order to establish a "contribution to capital," a taxpayer must prove that the transferor of the asset had a definite purpose to enlarge the taxpayer's working capital. But that case did not turn on the presence of any such specific purpose. The purpose of the community contributions in *Brown Shoe* was to induce the taxpayer to locate or expand its operations in the local area, and this purpose was accomplished by contributing assets; there was no gratuitous attempt to enlarge the taxpayer's capital. The Court noted in passing the existence of a purpose to enlarge the taxpayer's working capital only in order to underline the fact that the community groups there were not customers paying compensation for services rendered. And, as in *Brown Shoe,* the State and Federal Governments here attempted to accomplish a general public goal by contributing facilities to the taxpayer. As in *Brown Shoe,* they were not paying for services.

The Court today, however, does not appear to decide this case on the presence or absence of any specific motive, intent, or purpose. Rather the Court constructs a series of guidelines that must be met before there can be a "contribution to capital." These guidelines seem to be based upon the value of the assets to the transferee. For the Court relies primarily on the fact that the publicly-financed facilities were "peripheral" to the railroad's business and did not materially contribute to the production of further income, and concludes that they were not therefore contributions to the railroad's capital. But the Court cites nothing in the statute, the Regulations. or our prior cases to warrant this strange definition of

"capital" when that term is used in the phrase "contribution to capital."

Brown Shoe made clear that "capital" was to be defined "as that term has commonly been understood in both business and accounting practice. . . ." 339 U. S., at 589. The facilities in the present case meet that test. They are certainly part of the respondent's capital under any traditional understanding of that term; they are assets permanently invested in the railroad's business. See p. —, *supra*. Indeed, many of these facilities are essential to the railroad's continued operation—a railroad bridge, for example, is an obvious physical necessity if the railroad is to operate. All of the facilities enlarged the railroad's working capital, were used in its business, and yielded tangible and intangible economic benefits to the railroad. And the Court even appears to acknowledge that these assets are "capital" in the normal sense of that term, since it concedes that the portion of the facilities constructed by the railroad with its own funds is depreciable.[8] I do not understand why that portion of the *same assets* that was contributed to the railroad is not also part of the railroad's capital. I would maintain the straightforward approach taken by *Brown Shoe* and *Detroit Edison*—nonshareholder additions to capital are "contributions to capital" unless they are direct payments for services rendered.

The Government argues that to allow the railroad to claim a depreciation deduction on these facilities as "contributions to capital" would lead to the "anomalous" result that although the railroad had incurred no expense with respect to the publicly-financed facilities, it could nevertheless recoup their cost. But if this is an anomaly. it is the same anomaly that existed in *Brown Shoe*.

[8] There is no dispute that the railroad can claim a depreciation deduction for its 10% share of the cost of the facilities.

The taxpayer there had not paid for the property contributed by the community groups, yet it was able to claim a full depreciation deduction on it. In short, this so-called anomaly is the ineluctable result of § 113 (a)(8)(B) which allowed a carry-over basis for nonshareholder contributions to capital. It was Congress that had created the anomaly, and it was for Congress to correct it. In enacting § 362 (c) of the 1954 Code,[9]

---

[9] Section 362 of the Internal Revenue Code of 1954, 26 U. S. C. § 362, provides in pertinent part:

"(a) Property acquired by issuance of stock or as paid-in surplus.

"If property was acquired on or after June 22, 1954, by a corporation—

* * * * *

"(2) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer.

* * * * *

"(c) Special rule for certain contributions to capital.

"(1) Property other than money.

"Notwithstanding subsection (a)(2), if property other than money—

"(A) is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

"(B) is not contributed by a shareholder as such,

"then the basis of such property shall be zero.

"(2) Money.

"Notwithstanding subsection (a)(2), if money—

"(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

"(B) is not contributed by a shareholder as such,

"then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess (if any) of the amount of such contribution over the amount of the reduction under the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer. The particular properties to which the reductions required by this

Congress did precisely that. It eliminated any depreciation deduction for nonshareholder contributions to capital by providing a zero basis for such transfers, but it did so only for property acquired on or after June 22, 1954.

In sum, Congress in 1954 rewrote the tax law so as to overrule *Brown Shoe* and prohibit depreciation to be taken on contributions to capital made by nonshareholders on or after June 22, 1954.[10] As it now turns out, Congress could have saved itself the trouble. For today the Court rewrites the law and prohibits depreciation to be taken on such assets the railroad has owned since the 1930's. I would follow the law as Congress wrote it and affirm the judgment of the Court of Claims.

---

paragraph shall be allocated shall be determined under regulations prescribed by the Secretary or his delegate."

[10] It was explicitly recognized that 26 U. S. C. § 362 (c) was enacted to overcome the effect of *Brown Shoe*. H. R. Rep. No. 1337, 83d Cong., 2d Sess., A 128; S. Rep. No. 1622, 83d Cong., 2d Sess., 271–272; *Veterans Foundation* v. *Commissioner*, 317 F. 2d 456, 458.